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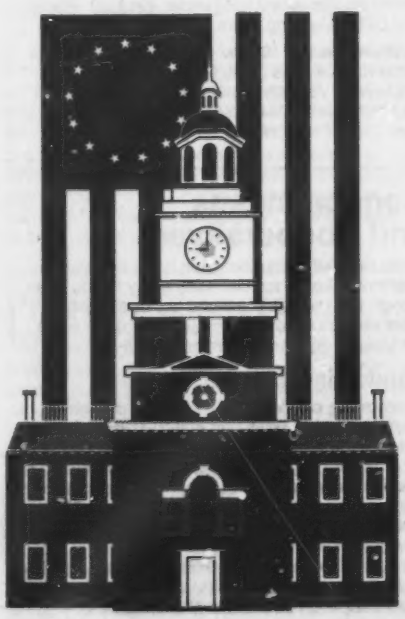
Residential Rental Property (Including Rental of Vacation Homes)

For use in preparing
1990 Returns



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Important Reminder

Loss limits. Any rental activity is a passive activity. There are passive loss limits and at-risk rules that may affect the amount of rental loss you can claim on your return.

Introduction

This publication discusses rental income and expenses, including depreciation, and explains how to report them on your return. It also covers casualty losses on rental property, the sale of rental property, and the passive activity limits and at-risk rules.

This publication is designed for those who only rent out a few residential dwelling units.

Free Publications and Forms

If you need information on a subject not covered in this publication, you may check our other free publications. To order publications and forms, call our toll-free telephone number 1-800-829-3676 or write the IRS Forms Distribution Center for your area as shown in the income tax package.

1. Rental Activities

This part of the publication discusses rental income and expenses, the rental of vacation homes, and the deduction for depreciation. It also explains how to figure a casualty loss on rental property, the limits on rental losses, and how to report rental income and expenses.

Rental Income

Rental income is any payment you receive for the use or occupation of property.

You generally must include in your gross income all amounts you receive as rent. In addition to amounts you receive as normal rent payments, there are other amounts that may be rental income.

Advance rent. Advance rent is any amount you receive before the period that it covers. Include advance rent in your rental income in the year you receive it regardless of the period covered or the method of accounting you use. Deduct rental expenses when you pay or incur them.

Example. You sign a 10-year lease to rent your property. In the first year you receive $5,000 for the first year's rent and $5,000 as rent for the last year of the lease. You must include $10,000 in your income in the first year.

Security deposits. Do not include a security deposit in your income when you receive it if you plan to return it to your tenant at the end of the lease. But, if during any year, you keep part or all of the security deposit because your tenant does not live up to the terms of the lease, include the amount you keep in your income in that year.

If an amount called a security deposit is to be used as a final payment of rent, it is advance rent. Include it in your income when you receive it.

Payment for canceling a lease. If your tenant pays you to cancel a lease, the amount you receive is rent. Include the payment in your income in the year you receive it whether you use the cash or accrual method of accounting.

Expenses paid by tenant. If your tenant pays any of your expenses, these payments are rental income. You must include them in your income. You can deduct the expenses that are otherwise deductible.

Example 1. The water and sewage bill for your rental property is mailed to the property. Under the terms of the lease, your tenant does not have to pay this bill. Your tenant pays the bill and deducts it from the normal rent payment.

Include in your rental income both the net amount of the rent payment and the amount the tenant paid for the utility bill. You can include the amount of the bill as a rental expense.

Example 2. While you are out of town, the furnace in your rental property stops working. Your tenant calls a plumber and pays for the necessary repairs. Your tenant deducts the plumbing bill from the rent payment.

Include in your rental income both the net amount of the rent payment and the amount the tenant paid for the plumbing repairs. You can include the cost of the repairs as a rental expense.

Property or services. If you receive property or services, instead of money, as rent, include the fair market value of the property or services in your rental income.

If the services are provided at an agreed upon or specified price, that price will be the fair market value in the absence of evidence to the contrary.

Example. Your tenant is a painter. He offers to paint your rental property instead of paying two months rent. You accept his offer.

Include in your rental income the amount the tenant would have paid for two months rent. You can include that same amount as a rental expense for painting your property.

Lease with option to buy. If the rental agreement gives the tenant the right to buy your rental property, payments you receive under the agreement are rental income until the tenant decides to buy the property. Unless the rental payments are applied toward the purchase price, payments made before that decision do not become part of the purchase price, but remain rental income.

Rental of property also used as a home. If you rent property that you also use as your home and you rent it for less than 15 days during the tax year, do not include the rent you receive in your gross income. You cannot deduct expenses other than allowable interest, taxes, and casualty or theft losses. See *Vacation Homes and Other Dwelling Units*, later.

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If you own a part interest in rental property, you must report your part of the rental income from the property.

Rental Expenses

This part discusses repairs and certain other expenses of renting property that you ordinarily can deduct from your gross rental income. It includes information on the expenses you may deduct if you rent a condominium or cooperative apartment, if you rent part of your property, or if you change your property to rental use. Depreciation, which you can also deduct from your gross rental income, is discussed later.

When to deduct. You generally deduct your rental expenses in the year you pay or incur them.

Pre-rental expenses. You can deduct your ordinary and necessary expenses for managing, conserving, or maintaining rental property from the time you make it available for rent. See *Vacant rental property,* later.

Expenses for rental property sold. If you sell property you held for rental purposes, you can deduct the ordinary and necessary expenses for managing, conserving, or maintaining the property until it is sold.

Vacant rental property. If you hold property for rental purposes, you may be able to deduct your ordinary and necessary expenses for managing, conserving, or maintaining the property while the property is vacant. However, you cannot deduct any loss of rental income for the period the property is vacant.

Repairs and Improvements

You can deduct the cost of repairs that you make to your rental property. You cannot deduct the cost of improvements. You recover the costs of improvements by taking depreciation (explained later).

Separate the costs of repairs and improvements and keep accurate records. You will need to know the cost of improvements when you sell or depreciate your property.

Repairs. A repair keeps your property in good operating condition. It does not materially add to the value of your property or substantially prolong its life. Repainting your property inside or out, fixing gutters or floors, fixing leaks, plastering, and replacing broken windows are examples of repairs.

If you make repairs as part of an extensive remodeling or restoration of your property, the whole job is an improvement.

Improvements. An improvement adds to the value of property, prolongs its useful life, or adapts it to new uses. Putting a recreation room in an unfinished basement, paneling a den, adding a bathroom or bedroom, putting decorative grillwork on a balcony, putting up a fence, putting in new plumbing or wiring, putting in new cabinets, putting on a new roof, and paving a driveway are examples of improvements.

If you make improvements to property before you begin renting it, add the cost of the improvement to the basis of the property. Basis is explained later under *Modified Accelerated Cost Recovery System (MACRS).*

Other Expenses

Other expenses you can deduct from your gross rental income include advertising, janitor and maid service, utilities, fire and liability insurance, taxes, interest, commissions for the collection of rent, ordinary and necessary travel and transportation, and other expenses discussed below.

Salaries and wages. You can deduct reasonable salaries and wages you pay to your employees. You can also deduct bonuses you pay to your employees if, when added to their regular salaries or wages, the total is not more than reasonable pay.

You can deduct reasonable wages you pay to your dependent child if your child is your bona fide employee. However, you cannot deduct the cost of meals and lodging for the child.

Rental payments for property. You can deduct the rent you pay for property that you use for rental purposes. If you buy a leasehold for rental purposes, you can deduct an equal part of the cost each year over the term of the lease.

Rental of equipment. You can deduct the rent you pay for equipment that you use for rental purposes. However, in some cases, lease contracts are actually purchase contracts. If so, you cannot deduct these payments. You can recover the cost of purchased equipment through depreciation.

Insurance premiums. You can deduct insurance premiums you pay. If you pay the premiums for more than one year in advance, each year you can deduct the part of the premium payment that will apply to that year. You continue to deduct your premium in this manner for as long as the insurance is in effect. You cannot deduct the total premium in the year you pay it.

Local benefits. Generally, you cannot deduct charges for local benefits that increase the value of your property, such as for putting in streets, sidewalks, or water and sewer systems. You must add them to the basis of your property. You can deduct local benefit taxes if they are for maintaining, repairing, or paying interest charges for the benefits.

Interest expense. You can deduct mortgage interest you pay on your rental property. Publication 545, *Interest Expense,* explains mortgage interest in detail.

Investment interest expense. The deduction for investment interest expense may be limited to your net investment income. See Publication 550, *Investment Income and Expenses,* for more information.

Charges for services. You can deduct charges you pay for providing services for your property, such as water, sewer, and trash collection.

Travel and transportation expenses. You can deduct your ordinary and necessary travel expenses when you are traveling away from home, as well as your ordinary and necessary transportation expenses when you are ***not*** traveling away from home, if the expenses are in connection with the management, conservation, or maintenance of property held by you for rental purposes. See *Limits on Deductions for Rental Expenses,* later. For additional information on travel and transportation expenses, see Publication 463, *Travel, Entertainment, and Gift Expenses,* and Publication 917, *Business Use of a Car.*

Part interest in property. If you own a part interest in rental property, you can deduct your part of the expenses that you paid.

Renting Part of Your Property

If you rent part of your property, you must divide certain expenses between the part of the property used for rental purposes and the part of the property used for personal purposes, as though you actually had two separate pieces of property.

You can deduct a part of some expenses, such as mortgage interest and property taxes, as a rental expense. You can deduct the other part, subject to certain limitations, only if you itemize your deductions. You can also deduct as a rental expense a part of other expenses that normally are nondeductible personal expenses, such as expenses for electricity, a second telephone line, or painting the outside of your house.

You do not have to divide the expenses that relate only to the rental part of your property. If you paint a room that you rent, or if you pay premiums for liability insurance in connection with renting a room in your home, your entire cost is a rental expense. You can deduct depreciation, discussed later, on the part of the property used for rental purposes as well as on the furniture and equipment you use for these purposes.

How to Divide Expenses

If an expense is for both rental use and personal use, such as mortgage interest or heat for the entire house, you must divide the expense between rental use and personal use. You can use any reasonable method for dividing the expense. The two most common methods are one based on the number of rooms in your home and one based on area.

Example. You rent a room in your house. The room is 12 × 15 feet, or 180 square feet. Your entire house has 1,800 square feet of floor space. You can deduct as a rental expense 10% of any expense that must be divided between rental use and personal use. Thus, if your heating bill for the year for the entire house was $600, $60 ($600 × 10%) is a rental expense. The balance, $540, is a personal expense and you cannot deduct it.

The number of people involved may be the proper method to use to divide certain expenses. For example, if you provide board along with rooms you rent to tenants, the most accurate method of dividing food costs between rental and personal expenses may be one based on the total number of people eating the food. Or, if you rent an apartment and your tenants have unrestricted use of your second telephone line, the number of people using it may be the best method for dividing the monthly charge for the telephone.

Limits on Deductions for Rental Expenses

If you rent out part of your property and you also use that or another part of the same property for personal purposes during the year, your deductions for rental expenses for the property may be limited as discussed later under *Vacation Homes and Other Dwelling Units.*

Business use of home. If you use part of your home for business (including work as an employee), your deductions for business use of your home are limited. See Publication 587, *Business Use of Your Home.*

Condominiums and Cooperatives

If you rent out a condominium or a cooperative apartment, some special rules apply to you even though you receive the same tax treatment as other owners of rental property. Condominiums are treated differently from cooperatives.

Condominium

If you own a condominium, you own outright a dwelling unit in a multi-unit building. You also own a share of the common elements of the structure, such as land, lobbies, elevators, and service areas. You and the other condominium owners may pay dues or assessments to a special corporation that is organized to take care of the common elements.

If you rent your condominium to others, you can deduct depreciation, repairs, upkeep, and other expenses, such as interest and taxes, and

assessments for the care of the common parts of the structure. You cannot deduct special assessments you pay to a condominium management corporation for improvements. But you may be able to recover your share of the cost of any improvement by taking depreciation.

Cooperative

If you have a cooperative housing arrangement, you own shares of stock in a corporation that owns or leases housing facilities. Because you are a tenant-stockholder, you can live in a dwelling unit controlled by the corporation and deduct certain expenses.

You are a tenant-stockholder even if you have the right to live in more than one dwelling unit in the cooperative. You need not actually live in any unit. You can rent them to others.

You can deduct your share of the project's deductible interest and taxes if the cooperative housing corporation meets the following conditions:

- The corporation must have only one class of stock outstanding,
- Each of the stockholders, because he or she owns stock in the corporation, must be able to live in, or rent for dwelling purposes, a house or apartment owned or leased by the corporation,
- No stockholder may receive any distribution out of capital, except on a partial or complete liquidation of the corporation, and
- At least 80% of the corporation's gross income for the tax year must be from the tenant-stockholders. For this purpose, gross income means all income received during the tax year, including any received before the corporation changed to cooperative ownership.

You figure your share of interest and taxes in the following way.

1) Divide the number of your shares of stock by the total number of shares outstanding, including any shares held by the corporation.
2) Multiply the corporation's deductible interest by the number you figured in (1). This is your share of the interest.
3) Multiply the corporation's deductible taxes by the number you figured in (1). This is your share of the taxes.

Special rule for allocation of taxes or interest. You may not have to use steps (1) through (3) above to figure your share of interest or taxes. If the corporation elects to allocate either interest or taxes to the stockholders, and the amount reasonably reflects the cost to the corporation of interest or taxes for your unit, you can deduct the amount allocated to you.

If you rent your cooperative apartment to others, you can deduct your share of the project's depreciation. In addition to interest and taxes, you can deduct repairs, upkeep, and other expenses, such as commissions and insurance.

Property Changed to Rental Use

If you change your home, apartment, or other property, or a part of it, to rental use at any time other than at the beginning of your tax year, you must divide yearly expenses such as depreciation, taxes, and insurance between rental use and personal use.

You can deduct as rental expenses only the part of the expense that is for the part of the year the property was used or held for rental purposes.

You cannot deduct depreciation or insurance for any property or part of property held for personal use. However, you can deduct the allowable part of the interest and tax expenses for personal use as an itemized deduction on Schedule A (Form 1040).

Example. You moved from your home in May 1990 and started renting it out on June 1, 1990. You can deduct as rental expenses seven-twelfths of your yearly expenses such as taxes and insurance.

You can deduct as rental expenses, starting with June, the amounts you pay for items generally billed monthly, such as utilities.

See *Personal home changed to rental use* later under *Modified Accelerated Cost Recovery System (MACRS)* for information about how to figure your deduction for depreciation.

Other limits. If you change property to rental use and later use part or all of it for personal purposes, there are other rules that apply to how much of your rental expenses you can deduct. These rules are explained next under *Vacation Homes and Other Dwelling Units.*

Vacation Homes and Other Dwelling Units

If you rent out part or all of a vacation home or other dwelling unit and you also use any part of the dwelling unit for personal purposes during the year, you must divide your expenses between the rental use and the personal use.

Depending on how your property was used, you may not be able to deduct any of your rental expenses, you may not be able to deduct all of your rental expenses in the year that you pay them, or you may not have to include any of the rent in your income.

Home and main home. The terms ***residence*** and ***principal residence,*** as used in prior editions of this publication, have been replaced with ***home*** and ***main home.***

Main home. If you have more than one home, your main home is the one you live in most of the time.

Dwelling Unit

For purposes of the rules that apply to vacation homes and other dwelling units, a dwelling unit includes a house, apartment, condominium, mobile home, boat, or similar property. It does not include property used exclusively as a hotel, motel, inn, or similar establishment.

Property is used exclusively as a hotel, motel, inn, or similar establishment if it is regularly available for occupancy by paying customers and is not used by an owner as a home during the year.

Used as Home

You use a dwelling unit as a home during the tax year if you use it for personal purposes more than 14 days and more than 10% of the number of days during the year that it is rented at a fair rental price. See *Personal Use* later for information on how to determine days of personal use.

To determine whether you use a dwelling unit as a home, do not count any day on which you use it for personal purposes as a day on which it is rented at a fair rental price.

Fair rental price. A fair rental price for your property generally is an amount that a person who is not related to you would be willing to pay. The rent you charge is ***not*** a fair rental price if it is substantially less than the rents charged for other properties that are similar to your property.

Ask yourself the following questions when comparing another property with yours.

- Is it used for the same purpose?
- Is it approximately the same size?
- Is it in approximately the same condition?
- Does it have similar furnishings?
- Is it in a similar location?

If any of the answers are no, the properties probably are not similar.

Examples. The following examples show how to determine whether your rental property is a dwelling unit or a hotel, motel, inn, or similar property.

Example 1. You converted the basement of your home into an apartment with a bedroom, a bathroom, and a small kitchen. You rent the apartment to college students during the regular school year. You rent to them on a 9-month (273 days) lease.

During the summer, your nephews stay with you for a month (30 days) and live in the apartment.

Your basement apartment is a dwelling unit (and not a hotel, motel, inn, or similar establishment) because you use it as a home (that is, for personal purposes for more than 14 days and more than 10% of the number of days for which it is rented).

Example 2. You rent out the guest bedroom in your home during the local college's homecoming, commencement, and football weekends (a total of 27 days). Your sister-in-law stays in the room, rent-free, for the last three weeks (21 days) in July.

The room itself is not a dwelling unit, but it is part of a dwelling unit. The room is not used exclusively as a hotel, motel, inn, or similar establishment because you use it as a home (that is, for personal purposes for more than 14 days and more than 10% of the number of days for which it is rented).

Example 3. You rent out a room in your home that is always available for occupancy by paying customers. You do not use the room yourself and you do not allow anyone other than paying customers to use the room. The room is used exclusively as a hotel, motel, inn, or similar establishment and is therefore not a dwelling unit.

Example 4. You own a cottage at the shore. You rent it out from June 1 through August 31, a total of 92 days. During 1990, the tenant who rented the cottage for the month of July was unable to use it from July 4 through July 8. The tenant allowed you to use the cottage for those 5 days. The tenant did not ask for a refund of or a reduction in the rent. Your family used the cottage for 3 of those days.

For purposes of determining whether you used the cottage as a home during 1990, you do not count those 3 days as days on which the cottage was rented at a fair rental price. The cottage was rented at a fair rental price for 89 days (92 − 3 = 89).

You use the cottage as a home if you use it for personal purposes for more than 14 days.

Personal Use

You use a dwelling unit for personal purposes on any day that it is used by:

- You or by any other person who has an interest in it, unless it is rented as a main home under a shared equity financing agreement (defined later),
- A member of your family or by a member of the family of any other person who has an interest in it, unless the family member uses the dwelling unit as his or her main home and pays a fair rental price (family includes only brothers and sisters, half-brothers and half-sisters, spouses, ancestors (parents, grandparents, etc.) and lineal descendants (children, grandchildren, etc.)),
- Anyone under an arrangement that lets you use some other dwelling unit, or
- Anyone at less than a fair rental price.

Rental to person with interest in unit. You use a dwelling unit for personal purposes if you rent it to someone who has an interest in it unless the

rental is under a shared equity financing agreement.

Shared equity financing agreement. This is an agreement under which two or more persons acquire undivided interests for more than 50 years in an entire dwelling unit, including the land, and one or more of the co-owners is entitled to occupy the unit as their main home upon payment of rent to the other co-owner or owners.

Rental to family member. You do not use a dwelling unit for personal purposes if you rent it at a fair rental price to a member of your family who uses it as his or her main home (unless he or she has an interest in the unit).

Charitable contributions. You use a dwelling unit for personal purposes if:

- You donate the use of the unit to a charitable organization,
- The organization sells the use of the unit at a fund-raising event, and
- The purchaser uses the unit.

Examples

The following examples show how to determine days of personal use.

Example 1. You and your neighbor are co-owners of a condominium at the beach. You rent the unit out to vacationers whenever possible. The unit is not used as a main home by anyone. Your neighbor uses the unit for two weeks every year.

Because your neighbor has an interest in the unit, both of you are considered to have used the unit for personal purposes during those two weeks.

Example 2. You and your neighbors are co-owners of a house under a shared equity financing agreement. Your neighbors live in the house and pay you a fair rental price.

Even though your neighbors have an interest in the house, the days your neighbors live there are not counted as days of personal use by you. This is because your neighbors rent the house as their main home under a shared equity financing agreement.

Example 3. You own a rental property that you rent to your son. Your son has no interest in this dwelling unit. He uses it as his main home. He pays you a fair rental price for the property.

Your son's use of the property is not personal use by you because your son is using it as his main home, he has no interest in the property, and he is paying you a fair rental price.

Example 4. You rent your beach house to Mary Smith. Mary rents her house in the mountains to you. You each pay a fair rental price.

You are using your house for personal purposes on the days that Mary uses it because your house is used by Mary under an arrangement that allows you to use her house.

Example 5. You rent an apartment to your mother at less than a fair rental price. You are using the apartment for personal purposes on the days that your mother rents it.

Days Not Counted as Personal Use

Some days you spend at the dwelling unit are not counted as days of personal use.

Repairs and maintenance. Any day that you spend repairing and maintaining your property on a full-time basis is not counted as a day of personal use. Do not count such a day as a day of personal use even if people related to you use the property for recreational purposes on the same day.

Example. You own a cabin in the mountains which you rent out during the summer. You spend 3 days at the cabin each May working full time each day to repair anything that was damaged over the winter and get the cabin ready for the summer. You also spend 3 days each September working full time to repair any damage done by renters and get the cabin ready for the winter.

These 6 days do not count as days of personal use.

Use as home before or after renting. If you use a dwelling unit as your main home before or after renting it, or trying to rent it, you may not have to count the days you use it as your main home as days of personal use.

12 months or more. If, for 12 or more consecutive months, you rent or try to rent a dwelling unit at a fair rental price, some of the days on which you use the property as your main home are not counted as days of personal use.

Do not count as days of personal use the days you used the property as your main home:

- During the year in which you began renting it or offering it for rent, but before you began renting it or offering it for rent, or
- During the year in which you stopped renting it or offering it for rent, but after you stopped renting it or offering it for rent.

Example. On February 28, 1990, you moved out of the house you had lived in for 6 years because you accepted a job in another town. You rent your house at a fair rental price from March 15, 1990, to May 14, 1991. On June 1, 1991, you move back to town and move back into your house.

Your use of the house as your main home from January 1 to February 28, 1990, and from June 1 to December 31, 1991, is not counted as personal use.

Sale before 12 months. If you sell or exchange your home before renting or offering it for rent at a fair rental price for 12 consecutive months, some of the days you use it as your main home are not counted as days of personal use. Do not count the days you use it as your main home during the year you rent or offer it for rent, but before you rented or offered it for rent, as days of personal use.

Example. On January 31, 1990, you moved out of the condominium where you had lived for 3 years. You offered it for rent at a fair rental price beginning on February 1, 1990. You are unable to rent it until April. On September 15, 1990, you sell the condominium.

Your use of the condominium from January 1 to January 31, 1990, is not counted as personal use.

You used the cottage for personal purposes for 14 days (the last 2 weeks in May).

Division of Expenses

If you use a dwelling unit for both rental and personal purposes, you must divide your expenses between the rental use and the personal use. For purposes of dividing your expenses:

- Any day that the unit is rented at a fair rental price is a day of rental use even if you have personally used the unit for that day, and
- A unit is ***not*** considered used for rental during the time that it is held out for rent but not actually rented.

Example. You offer your beach cottage for rent from June 1 through August 31 (92 days). Your family uses the cottage during the last 2 weeks in May (14 days). During 1990, you were unable to find a renter for the first week in August (7 days). The person who rented the cottage for July allowed you to use it over a weekend (2 days) without any reduction in or refund of rent. The cottage was not used at all before May 17 or after August 31.

The cottage was used for rental a total of 85 days (92 − 7 = 85). The days it was held out for rent but not rented (7 days) are not days of rental use. For purposes of dividing expenses, the July weekend on which you used it (2 days) is rental use because you received a fair rental price for the weekend.

Figuring Your Income and Deductions

How you figure your rental income and deductions depends on how much personal use you made of the property and how many days the property was rented.

General Rule

If you do not use a dwelling unit as a home, you divide your expenses between personal use and rental use based on the number of days it was used for each purpose.

Your deductible rental expenses can be more than your gross rental income. However, see *Passive Activity Limits*, later.

Where to report. Report the rental income and all of the rental expenses on Schedule E (Form 1040), *Supplemental Income and Loss.*

You can deduct allowable interest, taxes, and casualty losses for the personal use of the property on Schedule A (Form 1040) if you itemize deductions.

Property Used as a Home

If you use a dwelling unit as a home (as explained earlier), how you figure your rental income and deductions depends on how many days the unit was rented.

Rented less than 15 days. If you use a dwelling unit as a home and you rent it for less than 15 days during the year, you do not include in income any of the rental income. However, you cannot deduct any expenses as rental expenses.

You can deduct your allowable interest, taxes, and casualty and theft losses on Schedule A (Form 1040) if you itemize deductions.

Rented 15 days or more. If you use a dwelling unit as a home and rent it for 15 days or more during the year, you include all your rental income in your gross income. You must divide your expenses between your personal use and the rental use based on the number of days used for each purpose. If you had a net profit from the rental property for the year (that is, if your rental income is more than the total of your rental expenses, including depreciation), you can deduct all of your rental expenses. However, if you did not have a net profit from the rental property, you may not be able to deduct all of your rental expenses. See *Limit on Certain Expenses*, next.

Limit on Certain Expenses

If you use your rental property as a home (as explained earlier), rented it for 15 or more days during the year, and your rental expenses are more than your rental income, there is a limit on the amount you can deduct for certain rental expenses.

The purpose of the limit is to ensure that the expenses related to the rental property itself that are deductible only because of its use as rental property are used to offset only rental income. If the total of these expenses exceeds the rental income, the excess cannot be used to offset income from other sources. The excess can be carried forward to next year and treated as rental expenses for the next year.

Your deduction for the following expenses may be limited.

- The amount of interest expense and casualty loss on the rental property that you could ***not*** deduct if the property had been used only for personal purposes. (For purposes of this discussion, the term "casualty loss" includes theft losses.),
- Depreciation on the rental property, and

Expenses related to the rental property itself that you could ***not*** deduct if the property had been used only for personal purposes. This includes expenses such as property insurance, painting, repairs, and utilities.

Your deduction for the rental use portion of taxes is ***not*** limited.

The ***limit*** is the amount of your gross rental income that is more than the total of:

1) The rental use portion of taxes, interest, and casualty losses that would be deductible as an itemized deduction on Schedule A (Form 1040) if the rental property was used only for personal purposes, plus
2) The rental expenses that are not related to the rental property itself, such as rent collection fees, office supplies, and advertising.

Figuring the Amount You Can Deduct

If your rental expenses are more than your rental income, there are two ways to determine the amount you can deduct for certain rental expenses. (If the rental of the property is an activity that is not carried on to make a profit, see *Not Rented For Profit*, later.)

Use ***Method 1*** if you did not have a net profit for the year from the rental property and:

You did not have a casualty loss on the rental property during the year, and

You can deduct all of your mortgage interest paid during the year on the rental property.

Use ***Method 2*** if you did not have a net profit for the year from the rental property and:

You had a casualty loss on the rental property during the year, or

You cannot deduct all of your mortgage interest paid during the year on the rental property because of the limit on the deduction of home mortgage interest.

Method 1. Deduct your rental expenses for the year in the following order.

1) Deduct the rental use portion of interest and taxes.
2) Deduct rental expenses that are not directly related to the dwelling unit itself. This includes expenses such as rental agent fees, office supplies, depreciation on office equipment used exclusively in your business of renting property, and advertising fees.
3) Deduct the rental use portion of any expenses not described in (1) or (2) (other than depreciation and other basis adjustments). This includes expenses such as repairs, insurance, and utilities. You can deduct these expenses only if your gross rental income is more than the total of the expenses described in (1) and (2). If the expenses such as repairs, insurance, and utilities are more than your gross rental income reduced by the expenses described in (1) and (2), deduct only the amount that is equal to your gross rental income reduced by those expenses. See *Carryover of expenses*, later.
4) Deduct the rental use portion of depreciation and other basis adjustments to that rental property. You can deduct depreciation and other basis adjustments only if your gross rental income is more than the total of the deductions in (1), (2), and (3). If your depreciation and other basis adjustments are more than your gross rental income reduced by the total of the expenses in (1), (2), and (3), deduct only the amount that is equal to your gross rental income reduced by those expenses. See *Carryover of expenses*, later.

Method 2. If you have to use this method, you must first figure a limit on the amount you can deduct for certain expenses and then deduct your expenses (some of which are subject to the limit) in a certain order.

Figuring the limit. Figure the limit by subtracting the following items (in the order listed) from your gross rental income.

Taxes

Interest

Casualty loss

Expenses ***not*** related to the rental property

The amount you subtract for each item is explained next.

- ***Taxes.*** For purposes of figuring the limit on the deduction of certain expenses, subtract from your gross rental income the rental use portion of taxes paid on the rental property. Figure the rental use portion by multiplying the taxes on the rental property by the number of days of rental use and dividing by the number of days used for any purpose.
- ***Interest.*** For purposes of figuring the limit on the deduction of certain expenses, the amount of interest you subtract depends on whether you treat debt (a mortgage) on the rental property as not secured by a qualified home or whether all your mortgage interest is deductible. Home mortgage interest is discussed in Publication 936, *Limits on Home Mortgage Interest Deduction*. Publication 936 explains the terms "qualified home" and "secured debt."

  You can ***choose to treat debt on the rental property as not secured by a qualified home.*** See Publication 936 for information about the choice. If you make this choice, subtract from your gross rental income 10% of the rental use portion of the interest paid on the rental property. (If the rental property had been used only for personal purposes, you could deduct 10% of the interest paid during the year.) Figure the rental use portion by multiplying the interest on the rental property by the number of days of rental use and dividing by the number of days used for any purpose.

  If you treat the debt as secured by a qualified home and ***all of your mortgage interest is deductible as home mortgage interest,*** subtract from your gross rental income the rental use portion of interest paid on the rental property. Figure the rental use portion by multiplying the interest on the rental property by the number of days of rental use and dividing by the number of days used for any purpose.

  If you treat the debt as secured by a qualified home and ***any part of your mortgage interest is NOT deductible as home mortgage interest*** because of the limit on the deduction of home mortgage interest, figure the amount to subtract as follows.

  a) Figure the amount of mortgage interest that is deductible as home mortgage interest and the amount that is not deductible. This is explained in Publication 936.

  b) Allocate the amount that is deductible as home mortgage interest and the amount that is not deductible between your main home and the rental property.

  c) Add the deductible home mortgage interest allocated to the rental property and 20% of the amount allocated to the rental property that is not deductible. This is the amount of interest paid on the rental property that you could deduct if the property had been used only for personal purposes.

  d) Figure the rental use portion of the amount determined in (c) based on the number of days used for rental purposes. That is, multiply the result reached in (c) by the number of days used for rental purposes and divide by the total number of days used for any purpose.

  Subtract from your gross rental income the rental use portion determined in (d).
- ***Casualty loss.*** For purposes of figuring the limit on the deduction of certain expenses, figure the amount to subtract for casualty losses to the rental property as follows.

  a) Determine the amount of each of your casualty losses or gains to your rental property as explained later under *Casualty and Theft Losses on Rental Property*.

  b) Subtract the lesser of $100 or the amount of the loss from each casualty loss.

  c) Combine the remaining amount of loss and any gain.

  d) Reduce any net loss arrived at in (c) by 10% of your adjusted gross income (AGI). For purposes of the limit, figure your AGI without taking into account any income or deductions from the rental activity.

  e) Figure the rental use portion of the amount determined in (d) based on the number of days used for rental purposes. That is, multiply the result reached in (d) by the number of days of rental use and divide by the total number of days used for any purpose.

  Subtract from your gross rental income the rental use portion determined in (e).
- ***Expenses NOT related to the rental property.*** For purposes of figuring the limit on the deduction of certain expenses, subtract from your gross rental income any expenses that are not related to the property itself. This includes expenses such as rent collection fees, office supplies, advertising, and rental agent fees.

Ordering your deductions and applying the limit. You figure the amount you can deduct for certain rental expenses this year by deducting your expenses in the following order. The amount you can deduct for some of these expenses is subject to the limit.

1) ***Taxes.*** Deduct the rental use portion of taxes on the rental property. This is the same amount you used to figure the limit, earlier.
2) ***Interest.*** Deduct the rental use portion of the interest on the rental property that would have been deductible on Schedule A (Form 1040) if the property had been used only for personal purposes. This is the same amount you used to figure the limit, earlier.
3) ***Casualty losses.*** Deduct the rental use portion of casualty losses that would have been deductible on Schedule A (Form 1040) if the property had been used only for personal purposes. This is the same amount you used to figure the limit, earlier.
4) ***Expenses NOT related to the rental property.*** Deduct all rental expenses that are not directly related to the rental property itself. This is the same amount you used to figure the limit, earlier.
5) ***Expenses related to the rental property (subject to the limit).*** Deduct the rental use portion of all remaining rental expenses (other than depreciation on the rental property and the rental use portion of the amount of casualty loss not deducted earlier). These remaining expenses may include part of the rental use portion of interest.

   They ***do not include*** any of the rental use portion of interest if:

   - You treat debt on the rental property as debt secured by a qualified home, and
   - All of your mortgage interest is deductible as home mortgage interest.

   If both of these conditions are met, all of the rental use portion of your interest was deducted earlier under *Interest*.

   These expenses ***do include*** part of the rental use portion of interest if:

- You chose to treat the debt on the rental property as ***not*** secured by a qualified home, or
- Any part of the interest on the debt on your rental property is ***not*** deductible as home mortgage interest because of the limit on home mortgage interest.

If either of these conditions are met, these remaining expenses include the rental use portion of interest that you could not deduct if the property had been used for personal purposes only.

Figure the rental use portion of interest that you could not deduct if the property had been used only for personal purposes as follows.

a) Multiply the total interest paid on the debt on the rental property by the number of days of rental use and divide by the number of days used for any purpose.

b) Reduce the amount figured in (a) by the amount of any interest deducted earlier under *Interest*.

The result is the rental use portion of interest that you could not deduct if the property had been used only for personal purposes.

Figure the rental use portion of the other remaining expenses (utilities, insurance, etc.) by multiplying the amount of the expenses by the number of days of rental use and dividing by the number of days used for any purpose.

Deduct the rental use portion of the interest and the other expenses only up to the limit on certain expenses (described earlier). If the total is more than the limit, deduct only the amount that is equal to the limit and see *Carryover of expenses*, later.

6) ***Depreciation and other adjustments to basis (subject to the limit).*** Deduct the rental use portion of depreciation on the rental property and the rental use portion of the amount of casualty loss that would not be deductible if the property had been used only for personal purposes.

Figure the rental use portion of the amount of casualty loss that you could not deduct if the property had been used only for personal purposes as follows.

a) Multiply the amount of your casualty loss (reduced by any gains from casualties) on the rental property by the number of days of rental use and divide by the number of days used for any purpose.

b) Reduce the amount figured in (a) by any amount deducted earlier under *Casualty losses*.

The result is the rental use portion of the amount of casualty loss that you could not deduct if the property had been used only for personal purposes.

Deduct these expenses last. Deduct these expenses only up to the amount of the limit on certain expenses, explained earlier, reduced by the amount already deducted under *Expenses related to the rental property* (discussed earlier).

If the amount of depreciation and casualty losses is more than the reduced limit, deduct only the amount that is equal to the reduced limit and see *Carryover of expenses*, later.

Where to report. Report your rental income and all your deductible expenses for the rental use on Schedule E (Form 1040). This includes the rental use portion of interest, taxes, and casualty losses. You deduct allowable interest, taxes, and casualty losses for the personal use of the property on Schedule A (Form 1040) if you itemize deductions.

Carryover of expenses. If the total of your rental expenses is more than your gross rental income, the expenses that you are not allowed to deduct may be carried forward to the next year and treated as rental expenses for the same property. Any expenses carried forward to next year will be subject to any applicable limits next year. You can deduct the expenses carried over to a year only up to the amount of your rental income for that year, even if you do not use the property as your home for that year.

Not Rented For Profit

If your rental of a property is an activity that is not carried on to make a profit, you can deduct your rental expenses only up to the amount of your rental income. You ***cannot*** carry forward your rental expenses that are more than your rental income. For more information about the rules for an activity not engaged in for profit, see Publication 535, *Business Expenses*.

How to report. You report your rental income on line 22, Form 1040. You claim your deductible rental expenses as a miscellaneous deduction on line 21, Schedule A (Form 1040) if you itemize deductions.

You can deduct most miscellaneous deductions, including these, only to the extent the total is more than 2% of your adjusted gross income. For more information about miscellaneous deductions, see Publication 529, *Miscellaneous Deductions*.

Postponing decision. If for at least 3 years out of a period of 5 consecutive years your rental income is more than your rental expenses, your rental use of the dwelling unit is presumed to be for a profit. You may choose to postpone the decision of whether the rental is for profit by filing Form 5213, *Election To Postpone Determination as To Whether the Presumption That an Activity Is Engaged in for Profit Applies*.

See Publication 535, *Business Expenses*, for more information.

Depreciation

Depreciation is the annual deduction you take to recover the cost of rental property that is used for more than one year.

Several factors determine how much depreciation you can deduct. The main factors are: (1) your basis in the property, and (2) the recovery period for the property.

You can deduct depreciation only on the part of your property used for rental purposes. Depreciation reduces your basis for figuring gain or loss on a later sale or exchange. Use Form 4562, *Depreciation and Amortization*, to figure and report your depreciation. See *How to Report Rental Income and Expenses*, later. Also see Publication 534, *Depreciation*.

You should claim the correct amount of depreciation each tax year. If, in an earlier year, you did not claim depreciation that you were entitled to deduct, you must still reduce your basis in the property by the amount of the depreciation that you did not deduct. You cannot deduct the unclaimed depreciation in the current year or in any later tax year. However, you can claim the depreciation on an amended return for the earlier year. An amended return must be filed within 3 years from the date you filed your original return, or within 2 years from the time you paid your tax, whichever is later. A return filed early is considered filed on the due date. However, see *Carryover of expenses* under *Property Used as a Home*, earlier.

What can be depreciated. You can depreciate your property if it:

1) Is used in business or held for the production of income (such as rental property),
2) Has a useful life that can be determined (such as a building or furniture),
3) Has a useful life of more than one year (such as a new refrigerator), and
4) Is something that wears out, gets used up, decays, becomes obsolete, or loses value from natural causes.

To be depreciable, the property must meet ***all four*** of the above conditions.

You can depreciate both ***real property*** other than land and ***personal property.***

Real property is land and, generally, anything that is built on, growing on, or attached to land.

Buildings, fences, sidewalks, and trees are real property.

Personal property is property, such as machinery and equipment, that is not real estate.

Furniture, appliances, and lawn mowers are personal property.

Rented property. If you pay rent on property, you cannot depreciate that property. Only the owner can depreciate it. If you make permanent improvements to the property, you may be able to depreciate the improvements. See *Additions or Improvements to Property* later, under *Modified Accelerated Cost Recovery System (MACRS)*.

Land. You can never depreciate land. This generally includes the cost of clearing, grading, planting, and landscaping because these expenses are all part of the cost of land.

Cooperative apartments. If you are a tenant-stockholder in a cooperative housing corporation and you rent your cooperative apartment to others, you can deduct your share of the corporation's depreciation.

If you bought the stock as part of its first offering, you figure the amount of depreciation you can deduct in the following way.

1) Figure the depreciation for all the depreciable real property owned by the corporation. Depreciation methods are discussed later.
2) Subtract from (1) any depreciation for space owned by the corporation that can be rented but that may not be lived in by tenant-stockholders. The result is the yearly depreciation as reduced.
3) Divide the number of your shares of stock by the total number of shares outstanding, including any shares held by the corporation.
4) Multiply the yearly depreciation as reduced (from (2)) by the number you figured in (3). This is your share of the project's depreciation.

If you bought your cooperative stock after its first offering, you figure the basis of the depreciable real property to use in (1) above by:

1) Multiplying your cost per share by the total number of shares outstanding,
2) Adding to it the mortgage indebtedness on the property on the date you bought the stock, and
3) Subtracting from it the part of this sum that is not for the depreciable real property, such as the part for the land.

Your depreciation deduction for the year cannot be more than the part of your adjusted basis (defined later) in the stock of the corporation that is for your rental property.

Cannot be more than basis. The total of all your yearly depreciation deductions cannot be more than your cost or other basis of the property (defined later). For this purpose, the total depreciation must include any depreciation that you were allowed to claim, even if you did not claim it.

Property leased to tax-exempt entity. Generally, if you enter into a lease with a tax-exempt entity, you must use the alternate MACRS method (discussed later) of depreciation.

Tax-exempt entities include: the United States; individual states; U.S. possessions; any subdivision, agency, or instrumentality of the United States, a state, or a possession; organizations

exempt from federal income tax; and foreign persons and entities.

Methods of depreciation. There are now three systems involved in the computation of depreciation. The depreciation system that applies to a particular asset is determined by the type of asset and when the asset was placed in service. For ***tangible property*** you use:

MACRS (or alternate MACRS) if placed in service after 1986,

ACRS if placed in service after 1980 but before 1987, or

Straight line or an accelerated method of depreciation, such as the declining balance method, if placed in service before 1981.

This publication discusses MACRS only. If you need information about any other method of depreciation, see Publication 534, *Depreciation.*

Tangible property. Tangible property is any property that you can see or touch. This includes automobiles, buildings, and equipment.

Modified Accelerated Cost Recovery System (MACRS)

The modified accelerated cost recovery system (MACRS) applies to all tangible property placed in service during 1990.

If you placed your property in service before 1990, continue to use the same method of figuring depreciation that you used in the past.

Personal home changed to rental use. Use MACRS to figure the depreciation on property used as your home before 1987 and changed to rental property after 1986.

Property Classes Under MACRS

Each item of property that can be depreciated is assigned to a property class. The recovery period of a piece of property depends on the class the property is in. The property classes are:

3–year property,

5–year property,

7–year property,

10–year property,

15–year property,

20–year property,

Nonresidential real property, and

Residential rental property.

The class to which property is assigned is determined by its class life. Class lives and recovery periods for most assets are listed in the *Table of Class Lives and Recovery Periods* in Part II of Publication 534.

Optional tables. There are optional percentage tables in Publication 534 that you can use to figure your depreciation under MACRS.

Recovery Periods

Under MACRS, tangible property, generally used in rental activities, that you placed in service during 1990 falls into one of the following classes.

1) ***5–year property.*** This class includes computers and peripheral equipment, office machinery (typewriters, calculators, copiers, etc.), automobiles, and trucks.
   Depreciation on ***automobiles*** and ***computers*** is limited. See *Passenger Automobiles* and *Partial Business Use of Listed Property* in Publication 534.
2) ***7–year property.*** This class includes office furniture and fixtures (desks, files, etc.). This class also includes any property that does not have a class life and that has not been designated by law as being in any other class.
3) ***15–year property.*** This class includes roads and shrubbery (if depreciable).
4) ***Nonresidential real property.*** This class includes:
   - Any real property that is not residential rental property (defined later), and
   - Any real property that is section 1250 property with a class life of 27.5 years or more. (See *Real Property* under *Recapture of Depreciation,* later.)

   Nonresidential real property is depreciated over 31.5 years.
5) ***Residential rental property.*** This class includes any real property that is a rental building or structure (including mobile homes) for which 80% or more of the gross rental income for the tax year is rental income from dwelling units. If you live in any part of the building or structure, the gross rental income includes the fair rental value of the part you live in. Residential rental property is depreciated over 27.5 years.
   A dwelling unit is a house or an apartment used to provide living accommodations in a building or structure, but does not include a unit in a hotel, motel, inn, or other establishment where more than half of the units are used on a transient basis.

Note. There are other recovery classes that do not generally apply to rental property. These classes are not discussed in this publication. See Publication 534 for more information.

Placed in Service

Property is considered placed in service when it is ready and available for its specified use in a trade or business, in the production of income, in a tax-exempt activity, or in a personal activity. However, only property placed in service in a trade or business or in the production of income can be depreciated. For example, if property is placed in service in a personal use, no depreciation would be allowable. If the use of the property is changed to a business or income producing activity, depreciation would begin at the time of the change in use.

Example 1. On November 22, 1989, you purchased a dishwasher for your rental property. The appliance was delivered on December 7, 1989, but was not installed and ready for use until January 3, 1990. Because the dishwasher was not ready for use until 1990, it is considered placed in service in 1990.

If the appliance had been ready for use when it was delivered in 1989, it would have been considered placed in service in 1989, even if it was not actually used until 1990.

Example 2. On April 6, 1990, you purchased a house to use as residential rental property. You made extensive repairs to the house and had it ready for rent on July 5, 1990. You began to advertise the house for rent in July and actually rented it out beginning September 1, 1990. The house is considered placed in service in July when it was ready and available for rent. You can begin to depreciate the house in July.

Example 3. You moved from your home in July 1990. During August and September you made several repairs to the house. On October 1, 1990, you listed the property for rent with a real estate company which rented it on December 1, 1990. You can deduct your ordinary and necessary expenses for managing, conserving, or maintaining the property beginning on October 1, 1990, the date when the house was available for rent.

Basis

The basis of property you buy is usually its cost. The cost is the amount you pay for it in cash or in other property or services. Your cost also includes amounts you pay for:

Sales tax charged on the purchase,

Freight charges to obtain the property, and

Installation and testing charges.

Unstated interest. If you buy property on any time-payment plan that charges little or no interest, the basis of your property is your stated purchase price, less the amount considered to be unstated interest. See *Unstated Interest* in Publication 537, *Installment Sales.*

Real property. If you buy real property, such as a building and land, certain fees and other expenses you pay are part of your cost basis in the property.

Real estate taxes. If you buy real property and agree to pay real estate taxes on it that were owed by the seller, the taxes you pay are treated as part of your cost of the property. You cannot deduct them as taxes paid.

If you reimburse the seller for real estate taxes the seller paid for you, you can usually deduct that amount. Do not include that amount in the cost of the property.

Settlement fees and other costs. Settlement fees, such as legal and recording fees, are closing costs that you include in the basis of property. You also include:

Abstract fees,

Charges for installing utility services,

Surveys,

Transfer taxes,

Title insurance, and

Any amounts owed by the seller that you agree to pay, such as back taxes or interest, recording or mortgage fees, charges for improvements or repairs, and sales commissions.

Do not include in basis amounts placed in escrow for the future payment of items such as taxes and insurance.

Assumption of a mortgage. If you buy property and become liable for an existing mortgage on the property, your basis is the amount you pay for the property plus the amount that still must be paid on the mortgage.

Example. If you buy a building for $20,000 cash and assume a mortgage of $80,000 on it, your basis is $100,000.

Land and buildings. If you buy buildings and your cost includes the cost of the land on which they stand, you must divide the cost between the land and the buildings before you can figure the depreciation allowable on the buildings.

When you divide your cost between land and buildings, the part of the cost that is used as the basis of each asset is the ratio of the fair market value of that asset to the fair market value of the whole property at the time you buy it.

If you are not certain of the fair market values of the land and the buildings, you can divide the cost between them based on the assessed values for real estate tax purposes.

Example. You buy a house and land for $100,000. The purchase contract does not specify how much of the purchase price is for the house and how much is for the land.

The latest real estate tax assessment on the property is $80,000, of which $68,000 is for the house and $12,000 is for the land.

You can allocate 85% ($68,000 ÷ $80,000) of the purchase price to the house and 15% ($12,000 ÷ $80,000) of the purchase price to the land.

Your basis in the house is $85,000 (85% of $100,000) and your basis in the land is $15,000 (15% of $100,000).

Adjusted Basis

Before you can figure allowable depreciation, you may have to make certain adjustments (increases and decreases) to the basis of the property. The

result of these adjustments to the basis is the adjusted basis.

Increases to basis. You must increase the basis of any property by the cost of all items that must be depreciated, rather than deducted as an expense. This includes the cost of any improvements having a useful life of more than one year and amounts spent after a casualty to restore the damaged property.

Some of the items that you must add to the basis of property are:

- The cost of extending utility service lines to the property,
- Legal fees, such as the cost of defending and perfecting title, and
- Legal fees for obtaining a decrease in an assessment levied against property to pay for local improvements.

Improvements. Add to the basis of your property the amount an improvement actually cost you, including any amount you borrowed to make the improvement. This includes all direct costs, such as material and labor, but not your own labor. It also includes all expenses related to the improvement.

For example, if you had an architect draw up plans for remodeling your property, the architect's fee is a part of the cost of the remodeling. Or, if you had your lot surveyed to put up a fence, the cost of the survey is a part of the cost of the fence.

Assessments for local improvements. Assessments for items which tend to increase the value of property, such as streets and sidewalks, must be added to the basis of the property. You cannot deduct these items as taxes. For example, if your city installs curbing on the street in front of your house, and assesses you and your neighbors for the cost of curbing, you must add the assessment to the basis of your property.

Assessments for maintenance or repair or meeting interest charges are deductible, not depreciable.

Deducting vs. capitalizing costs. You cannot add to your basis costs that are deductible as current expenses. However, there are certain costs you can choose either to deduct or to capitalize. If you capitalize these costs, include them in your basis. If you deduct them, do not include them in your basis.

The costs you may be able to choose to deduct or to capitalize include carrying charges, such as interest and taxes, that you must pay to own property.

For more information about deducting or capitalizing costs, see Chapter 9 in Publication 535, *Business Expenses.*

Decreases to basis. You must decrease the basis of your property by any items that represent a return of your cost. Some of these include:

- The amount of any insurance or other reimbursement you receive as the result of a casualty or theft loss,
- Any deductible casualty loss not covered by insurance,
- Any amount you receive for granting an easement,
- Any residential energy credit you were allowed, if you added the cost of the energy items to the basis of your home,
- The section 179 deduction, if you elect to take it, and
- The amount of depreciation you could have deducted on your tax returns under the method of depreciation you selected. If you took less depreciation than you could have under the method you selected, you must decrease the basis by the amount you could have taken under that method.

  If you deducted more depreciation than you should have, you must decrease your basis by the amount you should have deducted, plus the part of the excess you deducted that actually lowered your tax liability for any year.

Other Basis

There are many times when you cannot use cost as a basis. You cannot use cost as a basis for property that you received:

- In return for services you performed,
- In an exchange for other property,
- As a gift,
- From your spouse or former spouse as the result of a divorce, or
- As part of an inheritance.

If you received property in one of these ways, see Publication 551, *Basis of Assets,* for information on how to figure your basis.

Basis of Property Changed to Rental Use

When you hold property for personal use and change it to rental use, such as renting out your former home, you figure the basis for depreciation using fair market value and adjusted basis.

Fair market value. This is the price at which the property would change hands between a buyer and a seller, neither being required to buy or sell, and both having reasonable knowledge of all the necessary facts. Sales of similar property, on or about the same date, may be helpful in figuring the fair market value of the property.

Figuring the basis. The basis for depreciation is the lesser of:

- The fair market value of the property on the date you changed it to rental use, or
- Your adjusted basis on the date of the change—that is, your original cost or other basis of the property, plus the cost of permanent improvements or additions since you acquired it, minus deductions for any casualty or theft losses claimed on earlier years' income tax returns and other decreases to basis.

Example. Several years ago you built your home for $40,000 on a lot that cost you $4,000. Before changing the property to rental use last year, you added $8,000 of permanent improvements to the house and claimed a $1,000 deduction for a casualty loss to the house. Because land is not depreciable, you can only include the cost of the house when figuring the basis for depreciation.

Your adjusted basis at the time of the change in use is $47,000 ($40,000 + $8,000 − $1,000).

On the date of the change in use, your property has a fair market value of $48,000, of which $6,000 is for the land and $42,000 is for the house.

The basis for depreciation on the house is the fair market value at the date of the change ($42,000), because it is less than your adjusted basis ($47,000).

Figuring MACRS Depreciation

You can figure your MACRS depreciation in one of two ways. You can either:

- Actually compute the deduction using the applicable depreciation method and convention over the recovery period, ***or***
- Use the percentage from the optional MACRS tables.

The deduction is the same under both methods.

Depreciation Methods

For property in the 5– or 7–year classes, you use the double (200%) declining balance method over 5 or 7 years and a half-year convention or the mid-quarter convention, if applicable (defined later). For property in the 15–year class, you use the 150% declining balance method over 15 years and a half-year convention.

You can also choose to use the 150% declining balance method over the class life (12 years for personal property with no class life). You make this election by entering "150 DB" in column (f) and "HY", for the half-year convention or "MQ", for the mid-quarter convention, in column (e), Part II of Form 4562.

For these classes of property, change to the straight line method for the first tax year for which that method, when applied to the adjusted basis at the beginning of the year, will yield a larger deduction.

You must use the straight line method and a mid-month convention (defined later) for nonresidential real property and residential rental property. Also see *Optional Tables,* later.

Instead of using the declining balance method, you may elect to use the straight line method with a half-year or mid-quarter convention over the recovery period. The election to use the straight line method for a class of property applies to all property in that class that is placed in service during the tax year of the election.

The election is made by entering "S/L" in column (f) and "HY" or "MQ" in column (e) of Part II of Form 4562, *Depreciation and Amortization.* Once made, the election to use the straight line method over the recovery period may not be changed. (See also *Alternate MACRS Method,* later.)

Declining balance method. To figure your MACRS deduction, first determine your declining balance rate of depreciation. This is determined by dividing the specified declining balance percentage (150% or 200%) by the recovery period. For example, for 5–year property, you divide 2.00 (200%) by 5 to get .4 (40%). For 15–year property, you divide 1.5 (150%) by 15 to get .1 (10%).

Multiply the adjusted basis of the property by the declining balance rate and apply the half-year (or applicable) convention to figure your depreciation for the first year. In later years,

1) Adjust your basis by subtracting the amount of depreciation allowable for the earlier years, then
2) Multiply your adjusted basis by the same rate used in the first year.

Follow steps (1) and (2) each year that you use the declining balance method.

Declining balance rates. The following table shows the applicable declining balance rate for each class of property and the first year for which the straight line method will give an equal or greater deduction.

Class	Declining Balance Rate	Year
5	40%	4th
7	28.57%	5th
15	10%	7th

Straight line method. To figure your MACRS deduction under the straight line method, you must figure a new depreciation rate for each tax year in the recovery period. For any tax year, figure the straight line rate by dividing the number 1 by the years remaining in the recovery period at the beginning of the tax year. Multiply the unrecovered basis of the property by the straight line rate. You must figure the depreciation for the first year using the applicable convention (see *Conventions,* later). If the remaining recovery period at the beginning of the tax year is less than one year, the straight line rate for that tax year is 100%.

Example. Using the straight line method for property with a 5–year recovery period, the

straight line rate is 20% (1 divided by 5) for the first tax year. After applying the half-year convention, the first year rate is 10% (20% divided by 2).

At the beginning of the second year, the remaining recovery period is 4½ years because of the half-year convention. The straight line rate for the second year is 22.2222% (1 divided by 4.5).

To figure your depreciation deduction for the second year:

1) Subtract the depreciation taken in the first year from the basis of the property, and
2) Multiply the remaining basis by the second year rate.

Residential rental and nonresidential real property. In the first year you claim depreciation for residential rental and nonresidential real property, you can only claim depreciation for the number of months the property is in use and you must use the mid-month convention (defined later). Also, for the first year of depreciation under the alternate MACRS method (described later), you must use the mid-month convention to figure your depreciation deduction.

Conventions

In the year that you place property in service or in the year that you dispose of property, you are only allowed to claim depreciation for a part of the year. The part of the year (or convention) depends on the class of the property.

A half-year convention is used to figure the deduction for property other than nonresidential real and residential rental property. Under a special rule, a mid-quarter convention may have to be used (discussed later). For nonresidential real and residential rental property, use a mid-month convention in all situations.

Half-year convention. Under MACRS, the half-year convention treats all property placed in service, or disposed of, during a tax year as placed in service, or disposed of, in the middle of that tax year.

A half year of depreciation is allowable for the first year property is placed in service, regardless of when the property is placed in service during the tax year. For each of the remaining years of the recovery period, you will take a full year of depreciation. If you hold the property for the entire recovery period, a half year of depreciation is allowable for the year following the end of the recovery period. If you dispose of the property before the end of the recovery period, a half year of depreciation is allowable for the year of disposition.

Mid-quarter convention. Under a mid-quarter convention, all property placed in service, or disposed of, during any quarter of a tax year is treated as placed in service, or disposed of, at the middle of the quarter.

A mid-quarter convention must be used instead of a half-year convention if the following conditions occur in the last 3 months of a tax year.

- You place in service depreciable property other than nonresidential real and residential rental property, and
- The total basis of that property is more than 40% of the total bases of all such depreciable property you place in service during the year (whether or not all of the property is subject to MACRS).

For tax years beginning after March 31, 1988, you do not include in the total basis any property placed in service and disposed of during the same tax year. You can elect to have this provision apply to tax years beginning before April 1, 1988.

Example. During 1990, John Joyce purchases a dishwasher for $400, which he places in service in January; used furniture for $100, which he places in service in September; and a refrigerator for $500, which he places in service in October. John uses the calendar year as his tax year. The total bases of all property placed in service in 1990 is $1,000. The basis of the refrigerator is $500 and it was placed in service during the last 3 months of his tax year. Since the basis of $500 exceeds 40% of the total bases of all property ($1,000) placed in service during 1990, John must use the mid-quarter convention for all three items. The dishwasher, refrigerator, and used furniture are 7-year property under MACRS.

Mid-month convention. Under a mid-month convention, all property placed in service, or disposed of, during any month is treated as placed in service, or disposed of, in the middle of that month.

Table A — **MACRS 5-Year Property**

Year	Half-year convention	Mid-quarter convention			
		First quarter	Second quarter	Third quarter	Fourth quarter
1	20.00%	35.00%	25.00%	15.00%	5.00%
2	32.00	26.00	30.00	34.00	38.00
3	19.20	15.60	18.00	20.40	22.80
4	11.52	11.01	11.37	12.24	13.68
5	11.52	11.01	11.37	11.30	10.94
6	5.76	1.38	4.26	7.06	9.58

Table B — **MACRS 7-Year Property**

Year	Half-year convention	Mid-quarter convention			
		First quarter	Second quarter	Third quarter	Fourth quarter
1	14.29%	25.00%	17.85%	10.71%	3.57%
2	24.49	21.43	23.47	25.51	27.55
3	17.49	15.31	16.76	18.22	19.68
4	12.49	10.93	11.97	13.02	14.06
5	8.93	8.75	8.87	9.30	10.04
6	8.92	8.74	8.87	8.85	8.73

Table C — **MACRS 15-Year Property**

Year	Half-year convention	Mid-quarter convention			
		First quarter	Second quarter	Third quarter	Fourth quarter
1	5.00%	8.75%	6.25%	3.75%	1.25%
2	9.50	9.13	9.38	9.63	9.88
3	8.55	8.21	8.44	8.66	8.89
4	7.70	7.39	7.59	7.80	8.00
5	6.93	6.65	6.83	7.02	7.20
6	6.23	5.99	6.15	6.31	6.48

Table I

Residential Rental Property (27.5-year)

Year	Use the column for the month of taxable year placed in service											
	1	2	3	4	5	6	7	8	9	10	11	12
1	3.485%	3.182%	2.879%	2.576%	2.273%	1.970%	1.667%	1.364%	1.061%	0.758%	0.455%	0.152%
2	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636
3	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636
4	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636
5	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636
6	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636	3.636

Table II

Nonresidential Real Property (31.5-year)

Year	Use the column for the month of taxable year placed in service											
	1	2	3	4	5	6	7	8	9	10	11	12
1	3.042%	2.778%	2.513%	2.249%	1.984%	1.720%	1.455%	1.190%	0.926%	0.661%	0.397%	0.132%
2	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175
3	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175
4	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175
5	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175
6	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175	3.175

Optional Tables

Optional depreciation tables can be used to compute annual depreciation under MACRS. The percentages in Tables A, B, and C make the change from declining balance to straight line in the year that straight line will yield a larger deduction. See *Depreciation methods* earlier.

How to use the tables. The following section explains how to use the optional table for both personal property and real property.

Personal property. For personal property, figure the depreciation deduction by multiplying your basis (explained earlier) in the property by a certain percentage. The percentages for the first 6 years are shown in the preceding tables for 5–, 7–, and 15–year property. The tables take the half-year and mid-quarter conventions into consideration in figuring percentages. Use Table A for 5–year property, Table B for 7–year property, and Table C for 15–year property. Use the percentage in the first column (half-year convention) unless you must use the mid-quarter convention (explained earlier). If you must use the mid-quarter convention, use the column that corresponds to the calendar year quarter in which you placed the property in service.

If you choose the straight line depreciation method, see Publication 534 for more information on how to figure the depreciation.

Example 1. You purchased a stove and refrigerator and placed them in service on February 1, 1990. Your basis in the stove is $300 and your basis in the refrigerator is $500. You use the year 1 line of Table B, in the half-year convention column to compute the depreciation on the stove and refrigerator. Your 1990 depreciation deduction on the stove is $43 ($300 × .1429). Your 1990 depreciation deduction on the refrigerator is $71 ($500 × .1429).

Example 2. Assume the same facts in Example 1, except you buy the refrigerator in October 1990 instead of February. You cannot use the half-year convention column to figure depreciation on the stove and refrigerator. Your basis of the refrigerator ($500), placed in service in the last 3 months of the tax year, is more than 40% of the total bases of all property ($800) placed in service during 1990. Use the mid-quarter convention columns to figure your depreciation. Because the stove was placed in service in the first quarter of the year, you use the first quarter column of Table B to find the depreciation percentage on the year 1 line. Your 1990 depreciation deduction on the stove is $75 ($300 × .25). You use the fourth quarter column of Table B to find the depreciation percentage on the refrigerator since you placed it in service in the fourth quarter of 1990. Your depreciation deduction on the refrigerator is $18 ($500 × .0357).

Real property. Tables I and II give the percentages for the first 6 years for real property placed in service after 1986. Table I covers residential rental property. Table II covers nonresidential real property. Choose the table for the class of property. Then find the column for the month that you placed the property in service. Use the percentages listed for that month for your depreciation deduction. The mid-month convention is considered in the percentages used in the tables.

Example. You purchased a single family rental house and placed it in service on February 1, 1990. Your basis in the house is $80,000. Use the percentage from the first line (year 1) of Table I, Residential Rental Property, column 2 (February), to compute your depreciation. Your 1990 depreciation deduction is $2,546 ($80,000 × .03182).

Additions or Improvements to Property

Figure the depreciation deduction for any additions or improvements to any property as if you placed the property in service at the same time the addition or improvement was made.

The MACRS class for the addition or improvement is determined by the MACRS class of the property to which the addition or improvement is made. Figure depreciation beginning on the date the addition or improvement is placed in service, or, if later, the date the property to which the addition or improvement was made is placed in service.

Example. You own a residential rental house that you are depreciating under ACRS. If you put an addition onto the house, and you place the improvement in service after 1986, you use MACRS for the addition. Under MACRS the addition would be depreciated as residential rental property.

Alternate MACRS Method

If you choose, you can use an alternate MACRS method for most property. Under this method you use the straight line method of depreciation.

The following chart shows the recovery periods for property you depreciate under the alternate MACRS method.

Property	Recovery Period
Personal property with no class life	12 years
Nonresidential real and residential rental property	40 years
Section 1245 property that is real property with no class life	40 years
Automobiles and light duty trucks	5 years
Computers and peripheral equipment	5 years
Most other property	Class life

You can find the class life assigned to many properties in the *Table of Class Lives and Recovery Periods* in Part II of Publication 534. If your property is not listed in the table, it is considered to have no class life.

Use the mid-month convention for nonresidential real and residential rental property. For all other property, use the half-year or mid-quarter convention.

Election. You make the election to use the alternate MACRS method by entering the depreciation on line 15, Part II of Form 4562, *Depreciation and Amortization.*

The election of the alternate MACRS method for a class of property applies to all property in that class that is placed in service during the tax year of the election. However, the election applies on a property-by-property basis for nonresidential real and residential rental property.

Once you make the election to use the alternate MACRS method you cannot change your election.

Note. If you use accelerated depreciation, you may have to file Form 6251, *Alternative Minimum Tax—Individuals.* Accelerated depreciation includes MACRS and ACRS and any other method that allows you to deduct more depreciation than you could deduct using a straight line method. For more information, see Publication 909, *Alternative Minimum Tax for Individuals.*

Excluded Property

You cannot use MACRS for certain personal property placed in service before 1987 (before August 1, 1986, if election made) that is transferred after 1986 (after July 31, 1986, if election made). Generally, if you acquired the property from a related party, or if you or a related party used the property before 1987, you cannot use MACRS. Property that does not come under MACRS must be depreciated under ACRS or one of the other methods of depreciation, such as straight line or declining balance. In addition, you may elect to exclude certain property from the application of MACRS.

See Publication 534 for more information.

Casualty and Theft Losses on Rental Property

Losses to rental property that are the result of casualties or theft are discussed in this section. As a result of a casualty or theft, you may suffer a loss of property used for personal or rental purposes. You may be able to deduct the loss on your federal income tax return. If you have a casualty or theft loss to your personal property (property not used in a business), see Publication 547, *Nonbusiness Disasters, Casualties, and Thefts,* for information.

Casualty. The damage, destruction, or loss of property is a casualty if it results from a specific event that is sudden, unexpected, or unusual in nature.

Theft. The unlawful taking and removing of your money or property with the intent to deprive you of it is a theft.

Proof of loss. You must be able to show that you actually have had a casualty or theft loss and the amount of the loss.

For a ***casualty*** loss you should be able to show:

- The type of casualty (car accident, fire, storm, etc.) and when it occurred,
- That your loss was the direct result of the casualty, and
- That you were the owner of the property, or, if you leased the property from someone else, that you were contractually liable to the owner for the damage.

For a ***theft*** loss, you should be able to show:

- When you discovered that your property was missing,
- That your property was actually stolen, and
- That you were the owner of the property.

Business Casualty Loss Deduction

Generally, you can deduct a loss to business property or to income-producing property, such as rental property, caused by a fire, storm, accident, or other casualty. You must figure the loss for each property damaged or destroyed. For example, if a casualty damages a building and trees, both of which are a part of the same property, you figure separate losses for the building and the trees.

Property Completely Destroyed

If your property is completely destroyed, your deductible loss is the adjusted basis of the property minus any salvage value and any insurance or other compensation you received or expect to receive.

Example. You owned a building that you rented out. The building had an adjusted basis of $80,000, not including the land, at the time it was completely destroyed by fire. Its fair market value just before the fire was $70,000. Because your building was completely destroyed, your deductible loss is your adjusted basis for the building, $80,000, minus any salvage value, insurance, or other recovery.

Property Partially Destroyed

If your property is partially destroyed, your deductible loss is the decrease in value of the property

because of the casualty, or the adjusted basis of the property damaged, whichever is less. From this amount (the smaller of adjusted basis or decrease in value), you must subtract the insurance or other compensation you received or expect to receive.

Example. In March, 1987, you bought property for rental purposes. You paid $15,000 for the land and $60,000 for the building. You also paid $3,000 for trees and shrubs. For the years 1987 through 1989 you took total depreciation of $6,091 for the building. In January 1990 the building was completely destroyed by fire. The trees and shrubs were damaged.

Appraisers determined that the trees and shrubs were worth $4,500 before the fire, but only $3,000 after the fire. The trees and shrubs were not covered by insurance. The building was insured for its fair market value of $90,000. Shortly after the fire, the insurance company paid you $90,000 in full settlement of its liability.

You figure your gain or loss from the fire as follows:

	Building	Trees and shrubs
Value before fire	$90,000	$4,500
Value after fire	-0-	3,000
Decrease in value	$90,000	$1,500
Adjusted basis	$53,909	$3,000
Insurance recovery	$90,000	$ -0-
Minus: Adjusted basis of building	53,909	
Minus: Decrease in value of trees and shrubs		1,500
Gain from fire insurance proceeds on building	$36,091	
Loss from damage to trees and shrubs		$1,500

You can deduct the $1,500 casualty loss from the damage to the trees and shrubs. You have a $36,091 gain on the building.

When you receive money, including insurance proceeds, you generally must report any gain. However, under certain circumstances, you may defer the payment of tax by choosing to postpone reporting the gain. To do this, you must generally buy replacement property within 2 years after the close of the tax year in which you receive the insurance proceeds. To postpone reporting the gain, the cost of the replacement property must be equal to or more than the net proceeds you received. For more information about business casualty losses, see Publication 334, *Tax Guide for Small Business*, Chapter 25.

Property Used Partly for Rental Purposes

When you use property partly for rental purposes and partly for personal purposes, you must figure the casualty or theft loss deduction as though two separate properties were affected. The personal loss must be reduced by $100, and the total of all such losses during the year must be reduced by 10% of your adjusted gross income. For more information about nonbusiness (personal) casualty and theft losses, see Publication 547.

Example. You live in half of your house and rent out the other half. The original cost of the house was $40,000, not including the land. You did not make any improvements or additions to the house.

A flood in 1990 caused damage to the entire house. The fair market value of the house was $38,000 before the flood and $32,000 after the flood. Your house was insured and you received $4,000 for the damage to it. You claimed $2,400 depreciation on the rental part of the house before the flood. You had no other casualty losses in 1990, and your adjusted gross income was $30,000.

You figure your deductible business casualty loss of $1,000 and your deductible personal casualty loss of zero as follows:

	Business use property	Personal use property
Decrease in value of house:		
Value before flood (total $38,000)	$19,000	$19,000
Value after flood (total $32,000)	16,000	16,000
Decrease in value	$ 3,000	$ 3,000
Adjusted basis of house:		
Rental part ($20,000 cost minus $2,400 depreciation)	$17,600	
Personal part (cost same as adjusted basis)		$20,000
Loss on house (smaller of adjusted basis or decrease in value)	$ 3,000	$ 3,000
Minus: Insurance received	2,000	2,000
Loss on house	$ 1,000	$ 1,000
Minus: $100 and 10% limits on property held for personal use		3,100
Deductible business casualty loss	$ 1,000	
Deductible personal casualty loss		$ -0-

When to Deduct a Loss

A casualty usually is apparent when it happens. Sometimes you may not discover a theft until later. The year in which you discover a theft affects the year in which you can deduct a theft loss.

Casualty Losses

Generally, you can deduct casualty losses only in the tax year in which they happen. This is true even if you do not repair or replace the damaged property until a later year. If you are liable for casualty damage to leased property, you deduct your loss in the year it is determined that you are liable. This may not be the same year in which you pay for the damages.

If you have a loss from a disaster that occurred in an area that the President of the United States later declares eligible for federal disaster assistance, see *Disaster Area Losses* in Publication 547.

Theft and Embezzlement Losses

Generally, you can deduct theft and embezzlement losses only in the year that you discover the property was stolen. You must prove that there was a theft and establish the year in which you discover the property was stolen. You do not have to prove the date it was stolen.

Insurance Claims

If you have filed a claim for reimbursement, and there is reason to believe that you will recover all or part of the loss, you must reduce the loss by the expected recovery. This is true even if you do not receive payment until a later tax year. You have reason to believe that you will recover all or part of the loss if you have filed suit for damages.

If your property is covered by insurance, you should file a timely insurance claim for reimbursement of a loss. Otherwise, you cannot deduct any part of this loss as a casualty or theft loss. However, that portion of the loss that is not covered by insurance, for example, a deductible, is not subject to this rule.

If you suffer a loss to property used only for business purposes, you may deduct any amount that is more than the insurance policy's coverage.

If you suffer a loss to property used for personal purposes, you must follow the rules explained in Publication 547.

How to Report

If you had a casualty or theft that involved your rental property, you figure the net gain or loss on Form 4684, *Casualties and Thefts*. Report any net gain or loss from lines 13 and 20a, Section B of Form 4684, on line 14, Part II of Form 4797, *Sales of Business Property*, or on line 15, Form 1040, if you do not use Form 4797 to report other gains and losses. If you do not use Form 4797, write "Form 4684" on line 15 of Form 1040. Report any long-term gain from line 21, Section B of Form 4684, on line 3, Part I of Form 4797.

Limits on Rental Losses

Generally, you cannot deduct losses from rental real estate activities unless you have income from other passive activities. See *Passive Activity Limits*, discussed later.

At-risk rules limit the amount of deductible losses from holding most real property placed in service after December 31, 1986.

Losses from passive activities are first subject to the at-risk rules.

Exception. If your rental losses are less than $25,000 ($12,500 if married filing separately), the passive activity limits probably do not apply to you. See *Losses From Rental Real Estate Activities*, later.

At-Risk Rules

The at-risk rules place a limit on the amount you can deduct as losses from activities often described as tax shelters. Holding real property (other than mineral property) was not subject to the at-risk rules before 1987.

Generally, any loss from an activity subject to the at-risk rules is allowed only to the extent of the total amount a taxpayer has at risk in the activity at the end of the tax year. A taxpayer is considered at risk in an activity to the extent of cash and the adjusted basis of other property the taxpayer contributed to the activity and certain amounts borrowed for use in the activity. See Publication 925, *Passive Activity and At-Risk Rules*, for more information.

Passive Activity Limits

You generally cannot offset income, other than passive income, with losses from passive activities. Nor can you offset taxes on income, other than passive income, with credits resulting from passive activities.

Any rental activity is a passive activity. For this purpose, a rental activity generally is an activity, the income from which consists of payments principally for the use of tangible property, rather than for the performance of substantial services.

Form 8582, *Passive Activity Loss Limitations*, is used to figure the amount of any passive activity loss for the current tax year for all activities and the amount of the passive activity loss allowed on your tax return. See *Rental Loss*, later, to determine whether you have to complete Form 8582.

Losses From Rental Real Estate Activities

You are allowed to deduct up to $25,000 ($12,500 if married filing separately and living apart from your spouse the entire year) of losses from rental

real estate activities in which you *actively participated* during the tax year. The offset allows you to deduct up to $25,000 of otherwise unallowable losses from rental real estate activities from other income (nonpassive income). The $25,000 ($12,500) figure is reduced if your adjusted gross income is more than $100,000.

A casualty or theft loss is not a passive activity deduction if losses that are similar in cause and severity do not happen regularly in your rental activity. Do not include such a loss with your other rental expenses when figuring your $25,000 ($12,500) limit.

Example. Jane has $40,000 in wages, $2,000 of passive income from a limited partnership, and $3,500 of loss from rental real estate in which she actively participated. $2,000 of Jane's $3,500 loss can be used to offset her passive income. The remaining $1,500 rental real estate loss can be used to offset her $40,000 wages.

Active participation. You actively participate in a rental real estate activity if you own at least 10% of the rental property. For these purposes, you are considered to own any portion of the property owned by your husband or wife.

Example. Mike, a bachelor, had the following income and losses during the tax year:

Salary	$ 42,300
Dividends	300
Interest	1,400
Rental loss	(4,000)

The rental loss resulted from the rental of a house Mike owned. Mike had advertised and rented the house to the current tenant himself. He also collected the rents, which usually came by mail. All repairs were either done or contracted out by Mike.

Even though the rental loss is a loss from a passive activity, if Mike is treated as actively participating, he can use the entire $4,000 loss to offset his other income.

Phase-out. The special $25,000 offset permitted for qualifying rental real estate activities is reduced by 50% of the amount by which your modified adjusted gross income is more than $100,000 ($50,000 for married filing separately). See *Modified adjusted gross income*, later.

Thus, generally, there is no relief from the passive activity loss limitations for an individual with adjusted gross income that is more than $150,000 ($75,000 for married individuals filing separate returns and living apart the entire year).

Additional information on the passive loss limits, including information on the treatment of unused disallowed passive losses and the treatment of gains and losses realized on the disposition of a passive activity, is provided in Publication 925.

Property used as a home. When figuring your passive activity losses, do not treat any income, deductions, gain, or loss related to the rental of property as items related to a passive activity if you used the property as your home (that is, you used it for personal purposes for more than 14 days and more than 10% of the number of days for which it was rented at a fair rental price).

How to Report Rental Income and Expenses

Report rental income on your return for the year you actually or constructively receive it (if you are a cash basis taxpayer). You are considered to constructively receive income when it is made available to you, for example, by being credited to your bank account.

For more information about when you constructively receive income, see Publication 538, *Accounting Periods and Methods*.

Expenses carried over. If you could not deduct all of your 1989 rental expenses because you used your property as a home, treat the part you could not deduct in 1989 as a 1990 rental expense.

Deduct the expenses carried over to a year only up to the amount of your gross rental income for the year, even if you did not use the property as your home for the year.

Where to report. Where you report rental income and expenses, including depreciation, depends on whether you provide certain services to your tenant.

If you rent out buildings, rooms, or apartments, and provide only heat and light, trash collection, etc., you normally report your rental income and expenses in Part I of Schedule E (Form 1040), *Supplemental Income and Loss*. However, see *Not Rented For Profit*, earlier.

If you provide additional services that are primarily for your tenant's convenience, such as regular cleaning, changing linen, or maid service, you report your rental income and expenses on Schedule C (Form 1040), *Profit or Loss From Business*. For information on Schedule C, see Publication 334, *Tax Guide for Small Business*. You also may have to pay self-employment tax on your rental income. See Publication 533, *Self-Employment Tax*.

Form 1098. If you paid $600 or more of mortgage interest on your rental property, you should receive a Form 1098, *Mortgage Interest Statement*, or a similar statement showing the interest you paid for the year. If you and at least one other person (other than your spouse if you file a joint return) were liable for, and paid interest on the mortgage, and the other person received the Form 1098, report the interest on line 12 of Schedule E. Attach a statement to your return showing the name and address of the other person. In the left margin of Schedule E, next to line 12, write "see attached."

Schedule E

Use Part I of Schedule E (Form 1040) to report your rental income and expenses. List your total income, expenses, and depreciation for each rental property. Be sure to answer the question on line 2.

If you have more than three rental or royalty properties, complete and attach as many Schedules E as are needed to list the properties. Complete lines 1 and 2 for each property. However, fill in the "Totals" column for lines 3, 4, 11, 19, 20, and 24 through 26 on only one Schedule E. The figures in the "Totals" column on that Schedule E should be the combined totals of all the schedules.

Page 2 of Schedule E is used to report income or loss from partnerships, S corporations, estates, trusts, and real estate mortgage investment conduits. If you need to use page 2 of Schedule E, use page 2 of the same Schedule E you used to enter the combined totals in Part I.

On page 1, line 20 of Schedule E, enter the depreciation you are claiming. You must complete and attach Form 4562, *Depreciation and Amortization*, only if:

- You are claiming depreciation on rental property placed in service during 1990, or
- You are claiming depreciation on any rental property that is listed property (such as a car) regardless of when it was placed in service, or
- You are claiming a section 179 expense deduction or amortization of costs that begins in 1990.

Otherwise, figure your depreciation on your own worksheet. You do not have to attach these computations to your return.

Example 1. Eileen Johnson owns a townhouse that she rents out. She receives $1,100 a month rental income. Her rental expenses for the year are as follows:

Fire insurance (1-year policy)	$ 200
Mortgage interest	5,000
Fee paid to real estate company for collecting monthly rent	572
General repairs	175
Real estate taxes imposed and paid in 1990	800

Eileen bought the property and placed it in service on January 1, 1990. Her basis for depreciation of the townhouse is $85,000. She is using the MACRS method with a 27.5-year recovery period. On April 1, 1990, Eileen bought a new dishwasher for the rental property at a cost of $425. She uses the MACRS method with a 7-year recovery period. She uses Form 4562 and the percentages under *Figuring MACRS Depreciation*, discussed earlier, to figure her MACRS deduction.

Eileen figures her net rental income or loss for the townhouse as follows:

Total rental income received ($1,100 × 12)		$13,200
Minus: Expenses		
Fire insurance	$ 200	
Mortgage interest	5,000	
Real estate fee	572	
General repairs	175	
Real estate taxes	800	
Total expenses		6,747
Balance		$ 6,453
Minus: Depreciation		
On townhouse ($85,000 × 3.485%)	$2,265	
On dishwasher ($425 × 14.29%)	61	
Total depreciation		2,326
Net rental income for townhouse		$ 4,127

Example 2. In January 1990, Mary Smith bought a condominium apartment to live in. Instead of selling the house she had been living in, she decided to change it to rental property. On February 1, 1990, she put it on the market to rent. Mary selected a tenant for the house and started renting it on April 1. Mary charges $550 a month for rent and collects it herself. Mary received a $550 security deposit from her tenant. Because she plans to return it to her tenant at the end of the lease, she does not include it in her income in 1990. Her expenses for the house are as follows:

Fire insurance (1-year policy)	$ 100
Mortgage interest	1,800
Miscellaneous repairs (after renting)	297
Real estate taxes imposed and paid in 1990	800

Mary must divide the real estate taxes, mortgage interest, and fire insurance between the personal use of the property and the rental use of the property. She can deduct eleven-twelfths of these expenses as rental expenses. She can deduct the balance of the allowable taxes and interest on Schedule A (Form 1040) if she itemizes her deductions. She cannot deduct the balance of the fire insurance because it is a personal expense.

Mary bought this house in 1973 for $35,000. Her property tax was based on assessed values of $10,000 for the land and $25,000 for the house. Between 1973 and 1988, Mary added several improvements to the house. She figures her adjusted basis as follows:

Cost of house	$25,000
Cost of remodeling kitchen	4,200
Cost of adding new recreation room	5,800
Cost of putting on new roof	1,000
Cost of paving driveway	600
Cost of adding patio and deck	2,400
Adjusted basis	$39,000

On February 1, 1990, when Mary changed her house to rental property, the property had a fair market value of $92,000. Of this amount, $20,000 was for the land and $72,000 was for the house.

Because Mary's adjusted basis is less than the fair market value on the date of the change, Mary uses $39,000 as her basis for depreciation.

Because the house is residential rental property, she must use either MACRS or alternate MACRS. She chooses the MACRS straight line method of depreciation over a period of 27.5 years.

She uses the MACRS Table I, illustrated earlier, to find her depreciation percentage. Because she placed the property in service in February, she uses the percentage in the second column.

On May 1, 1990, Mary paid $2,000 to have a furnace installed in the house. The furnace is residential rental property. She uses the MACRS Table I, column 5, to find her depreciation percentage.

Mary figures her net rental income or loss for the house in the following way:

Total rental income received ($550 × 9)		$4,950
Minus: Expenses		
Fire insurance ($100 × 1/12)	$ 92	
Mortgage interest ($1,800 × 1/12)	1,650	
Miscellaneous repairs	297	
Real estate taxes ($600 × 1/12)	733	
Total expenses		2,772
Balance		$2,178
Minus: Depreciation		
On house ($39,000 × 3.182%)	1,241	
On furnace ($2,000 × 2.273%)	45	
Total depreciation		1,286
Net rental gain for house		$ 892

Mary uses Part I of Schedule E to report her rental income and expenses. She enters her income, expenses, and depreciation for the house in the column for Property A. She uses Form 4562 to figure and report her depreciation. Mary's Schedule E and Form 4562 are shown later.

Rental Loss

If you have a loss on line 22, Schedule E, you may have to file Form 8582, *Passive Activity Loss Limitations*. See *Passive Activity Limits*, explained earlier. However, you do not have to complete Form 8582 if you meet *all* of the conditions listed below:

- You have losses only from rental real estate activities shown on line 22.
- You have no credits related to those activities.
- You actively participated in the operation of the activities.
- You have no losses or credits from other passive activities.
- You lived apart from your spouse all year (if you are married filing separately).
- Your total losses from the rental real estate activities are $25,000 or less ($12,500 or less if married filing separately and you lived apart from your spouse all year).
- Your modified adjusted gross income, defined below, is $100,000 or less ($50,000 or less if married filing separately and you lived apart from your spouse all year).
- You have income from rental activities shown on line 22 and you have no credits related to those activities.

If you do not meet all of the conditions listed above, you ***MUST*** complete and attach Form 8582.

Modified adjusted gross income is your adjusted gross income from line 31, Form 1040, figured without taking into account:

Passive activity loss,

Taxable social security or railroad retirement benefits,

Deductible contributions to an IRA or simplified employee pension plan, and

Excludable U.S. savings bond interest.

SCHEDULE E (Form 1040)

Department of the Treasury
Internal Revenue Service

Supplemental Income and Loss

(From rents, royalties, partnerships, estates, trusts, REMICs, etc.)

▶ Attach to Form 1040 or Form 1041.
▶ See Instructions for Schedule E (Form 1040).

OMB No. 1545-0074

1990

Attachment Sequence No. 13

Name(s) shown on return: Mary T. Smith

Your social security number: 123 00 4567

Part I Income or Loss From Rentals and Royalties Note: *Report farm rental income or loss from Form 4835 on page 2, line 39.*

1 Show the kind and location of each **rental property:**
A Brick House, 123 Main Street, Hometown, MD 23245
B
C

2 For each rental property listed on line 1, did you or your family use it for personal purposes for more than the greater of 14 days or 10% of the total days rented at fair rental value during the tax year? (See Instructions.)

	Yes	No
A		X
B		
C		

Rental and Royalty Income:		Properties A	B	C	D Totals (Add columns A, B, and C)
3 Rents received	3	4,950			4,950
4 Royalties received	4				
Rental and Royalty Expenses:					
5 Advertising	5				
6 Auto and travel	6				
7 Cleaning and maintenance	7				
8 Commissions	8				
9 Insurance	9	92			
10 Legal and other professional fees	10				
11 Mortgage interest paid to banks, etc. (see Instructions)	11	1,650			1,650
12 Other interest	12				
13 Repairs	13	297			
14 Supplies	14				
15 Taxes	15	733			
16 Utilities	16				
17 Wages and salaries	17				
18 Other (list) ▶	18				
19 Add lines 5 through 18	19	2,772			2,772
20 Depreciation expense or depletion (see Instructions)	20	1,286			1,286
21 Total expenses. Add lines 19 and 20	21	4,058			
22 Income or (loss) from rental or royalty properties. Subtract line 21 from line 3 (rents) or line 4 (royalties). If the result is a (loss), see Instructions to find out if you must file **Form 6198**	22	892			
23 Deductible rental loss. **Caution:** *Your rental loss on line 22 may be limited. See Instructions to find out if you must file Form 8582*	23	( )	( )	( )	
24 **Income.** Add rental and royalty income from line 22. Enter the total income here					24 892
25 **Losses.** Add royalty losses from line 22 and rental losses from line 23. Enter the total losses here					25 ( )
26 Total rental and royalty income or (loss). Combine amounts on lines 24 and 25. Enter the result here. If Parts II, III, IV, and line 39 on page 2 do not apply to you, enter the amount from line 26 on Form 1040, line 18. Otherwise, include the amount from line 26 in the total on line 40 on page 2.					26 892

For Paperwork Reduction Act Notice, see Form 1040 Instructions. Schedule E (Form 1040) 1990

Form **4562**

Department of the Treasury
Internal Revenue Service

Depreciation and Amortization
(Including Information on Listed Property)

▶ See separate instructions. ▶ Attach this form to your return.

OMB No. 1545-0172

1990

Attachment Sequence No. 67

Name(s) shown on return: Mary T. Smith

Identifying number: 123-00-4567

Business or activity to which this form relates: Rental of House

Part I **Election To Expense Certain Tangible Property (Section 179)** (**Note:** *If you have any "Listed Property," also complete Part V.*)

1 Maximum dollar limitation (see instructions)	1	$10,000
2 Total cost of section 179 property placed in service during the tax year (see instructions)	2	
3 Threshold cost of section 179 property before reduction in limitation	3	$200,000
4 Reduction in limitation—Subtract line 3 from line 2, but do not enter less than -0-	4	
5 Dollar limitation for tax year—Subtract line 4 from line 1, but do not enter less than -0-	5	

(a) Description of property	(b) Cost	(c) Elected cost
6		

7 Listed property—Enter amount from line 26	7	
8 Total elected cost of section 179 property—Add amounts in column (c), lines 6 and 7	8	
9 Tentative deduction—Enter the lesser of line 5 or line 8	9	
10 Carryover of disallowed deduction from 1989 (see instructions)	10	
11 Taxable income limitation—Enter the lesser of taxable income or line 5 (see instructions)	11	
12 Section 179 expense deduction—Add lines 9 and 10, but do not enter more than line 11	12	
13 Carryover of disallowed deduction to 1991—Add lines 9 and 10, less line 12 ▶	13	

Note: *Do not use Part II or Part III below for automobiles, certain other vehicles, cellular telephones, computers, or property used for entertainment, recreation, or amusement (listed property). Instead, use Part V for listed property.*

Part II **MACRS Depreciation For Assets Placed in Service ONLY During Your 1990 Tax Year (Do Not Include Listed Property)**

(a) Classification of property	(b) Mo. and yr. placed in service	(c) Basis for depreciation (Business use only—see instructions)	(d) Recovery period	(e) Convention	(f) Method	(g) Depreciation deduction
14 General Depreciation System (GDS) (see instructions):						
a 3-year property						
b 5-year property						
c 7-year property						
d 10-year property						
e 15-year property						
f 20-year property						
g Residential rental property	2-90	39,000	27.5 yrs.	MM	S/L	1,241
	5-90	2,000	27.5 yrs.	MM	S/L	45
h Nonresidential real property			31.5 yrs.	MM	S/L	
			31.5 yrs.	MM	S/L	
15 Alternative Depreciation System (ADS) (see instructions):						
a Class life					S/L	
b 12-year			12 yrs.		S/L	
c 40-year			40 yrs.	MM	S/L	

Part III **Other Depreciation (Do Not Include Listed Property)**

16 GDS and ADS deductions for assets placed in service in tax years beginning before 1990 (see instructions)	16	
17 Property subject to section 168(f)(1) election (see instructions)	17	
18 ACRS and other depreciation (see instructions)	18	

Part IV **Summary**

19 Listed property—Enter amount from line 25	19	
20 Total—Add deductions on line 12, lines 14 and 15 in column (g), and lines 16 through 19. Enter here and on the appropriate lines of your return. (Partnerships and S corporations—see instructions)	20	1,286
21 For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs (see instructions)	21	

2. Selling Your Rental Property

This part of the publication contains information that will help you report the sale of your rental property. It also has a discussion of rules for you to follow if the property you sell is your main home.

If you sell your rental property, you must know your basis for gain or loss, how to figure your gain or loss, and whether you must recapture any depreciation. You must also be able to figure any section 1231 gain or loss (gain or loss on the sale or exchange of certain types of property). See *Recapture of Depreciation* and *Section 1231 Gain or Loss*, later.

Form 1099–S. If you sell or exchange your rental property, the broker is required to file Form 1099-S, *Statement for Recipients of Proceeds From Real Estate Transactions.* The broker will file Form 1099–S with the Internal Revenue Service and will provide you with the information reported on the form. The broker cannot charge you separately for providing this form.

Basis and Adjusted Basis

Whether you bought your property, hired a contractor to build it for you, built it yourself, or received it as compensation for services, as a gift or inheritance, in payment of a debt, or in trade for other property, it is important that you know its basis. You must know its adjusted basis to figure gain or loss when you sell or otherwise dispose of your property.

You should keep records of transactions relating to the basis of your property for as long as you need them to prove the basis of the original or replacement property. For this reason, you should keep records of all capital improvements and additions (such as fences, porches, new rooms, etc.) that you make to your property.

Basis

The original basis of property depends on how and when you acquired the property.

Purchase. The original basis of property you bought is the price you paid for it. This generally includes your down payment and any indebtedness, such as a first or second mortgage, or notes you gave to the seller.

You can add to the cost of your property certain items that are charged to you at settlement or closing. They are a part of your original basis. These items include:

- Attorney's fees,
- Abstract fees,
- Charges for installing utility service,
- Surveys,
- Transfer taxes,
- Title insurance, and
- Any amounts that may be actually owed by the seller but which you agreed to pay, such as:
  - a) Back taxes or interest,
  - b) Recording or mortgage fees,
  - c) Charges for improvements or repairs, and
  - d) Selling commissions.

If the seller actually paid for any item for which you are liable, such as your share of the real property taxes for that year, you must reduce your basis by that amount if you are not charged for it at settlement.

If you are a tenant-stockholder in a cooperative housing development, your basis generally is the cost of your stock in the corporation. It includes your share of a mortgage on the building that you are required to pay as a condition of keeping your stock interest.

Your basis of a condominium is your cost.

Construction. If you contracted to have a building constructed on land that you own, your original basis is your basis of the land plus the amount it cost you to complete the building. This includes the cost of labor and materials, architect's fees, building permit charges, contractor's fees, utility meter and connection charges, and legal fees that are directly connected with building. If you construct all or part of the building yourself, its original basis is the total amount it cost you to complete it. The value of your own labor or any other labor you did not pay for is not part of the cost of the building.

Compensation. If you received your property as compensation for services, your basis is the fair market value of the property when you received it. You also must include this amount in your gross income as wages. If the services are rendered at an agreed upon or specified price, that price is presumed to be the fair market value in the absence of evidence otherwise.

Gifts made before 1977. If someone gave you property before 1977, your original basis is the donor's adjusted basis at the date of the gift. However, if the donor's adjusted basis was more than the fair market value of the property when it was given to you, you must use that fair market value as your basis to figure any possible loss when you sell or exchange your property.

If the fair market value was more than the donor's adjusted basis at the time of the gift, increase your basis by any federal gift tax paid on the gift. Do not increase your basis to more than the fair market value of the property when it was given to you.

If you received the property as a gift before 1921, your original basis is the fair market value of the property at the time of the gift.

Gifts made after 1976. If you received a gift after 1976, your basis in the gift (the donor's adjusted basis) is increased by the part of the gift tax paid that is due to the net increase in the value of the gift. This part is figured by multiplying the gift tax paid on the gift by a fraction. The numerator (top part) of the fraction is the net increase in value of the gift and the denominator (bottom part) is the amount of the gift. The net increase in value of the gift is the fair market value of the gift less the donor's adjusted basis.

Inheritance. If you inherited your property, the original basis of the property generally is its fair market value at the date of the decedent's death or the later alternate valuation date if chosen by the estate for federal estate tax valuation purposes. If a federal estate tax return was filed, the value listed there for the property generally is your basis. If no federal estate tax return was filed, use the appraised value for state inheritance or transmission tax purposes. If no return was filed, use the best available objective evidence of fair market value, such as an appraisal. See Publication 551, *Basis of Assets*, for more information.

Taxable trade. If you traded one property for another, the basis of the new property is its fair market value at the time of the trade unless you received the property in a nontaxable or partly nontaxable trade.

Nontaxable trade. A nontaxable trade is one in which property is exchanged solely for like property (such as a rental house for a rental house).

If you received your property in a nontaxable trade, the original basis of the property you received is the adjusted basis of the property you gave up, increased by any cash you paid or additional costs you had.

Partly nontaxable trade. A partly nontaxable trade is one in which you receive, in addition to like property, unlike property, money, or both.

If you received your property in a partly nontaxable trade, increase the adjusted basis of the property you gave up by any cash you paid, additional costs you had, and any gain recognized. Reduce this amount by any cash or unlike property you received and any loss recognized on the trade. For more information, see Publication 551.

Deferred gain. If you:

- Sold a home,
- Deferred gain from the sale of that home because you bought a new home, and
- Changed the new home to rental property,

you must reduce the basis of the new home by the amount of gain you deferred from the sale of the old home.

Example. In 1967 you bought your first house for $40,000. In 1977 you sold this house for $60,000 and bought a second house for $100,000. Because the cost of your new house was more than the selling price of your old house, you deferred your gain of $20,000. In 1988 you changed your second house to rental property.

The basis of your rental property is $80,000 ($100,000 price you paid minus $20,000 gain you deferred).

Adjusted Basis

Your adjusted basis is your original basis increased or reduced by certain amounts. Increase your basis by the cost of improvements and additions and by any other capital expenditures you make during the time you own the property. Reduce your basis by deductible casualty losses, payments for any easements or rights-of-way you grant, depreciation you take or could take, and by any other items that represent a return of your investment in the property.

See the discussion of adjusted basis earlier, under *Depreciation*.

Figuring Your Gain or Loss

A ***gain*** is the amount you realize from a sale or exchange minus your adjusted basis of the property. A ***loss*** is your adjusted basis of the property minus the amount you realize from a sale or exchange.

If you have a taxable gain or a deductible loss from a sale or exchange, it may be either a capital gain or loss or an ordinary gain or loss. In some situations part of your gain or loss may be a capital gain or loss and part may be an ordinary gain or loss. See *Recapture of Depreciation*, later.

Property Used Partly for Rental

If you sell or exchange property that you used for both rental and personal purposes, you must figure the gain or loss on the sale or exchange as though you had sold two separate pieces of property. You must divide the selling price, selling expenses, and the basis of the property between the rental portion and the personal portion. You

must deduct depreciation you took or could have taken from the basis of the rental part.

Gain or loss on the rental part of the property may be a capital gain or loss or an ordinary gain or loss, as discussed later. Any gain on the personal part of the property is a capital gain. You may not deduct a loss on the personal part.

Example. You sold a condominium in 1990 for $57,000. You bought the property in 1975 for $30,000. You used two-thirds of it as your home and rented out the other third. You claimed straight line depreciation totaling $3,750 for the rented part during the time you owned the property. You made no improvements to the property. Your expenses of selling the condominium were $3,600. You figure your gain or loss as follows:

	Rental (1/3)	Personal (2/3)
1) Selling price	$19,000	$38,000
2) Less selling expenses	1,200	2,400
3) Amount realized (adjusted sales price)	$17,800	$35,600
4) Basis	$10,000	$20,000
5) Less depreciation	3,750	
6) Adjusted basis	$ 6,250	$20,000
7) Gain (line 3 minus line 6)	$11,550	$15,600

Property Changed to Rental Use

If you sell or dispose of property you changed to rental use, you ***must make two separate computations.*** You must figure a gain, if any, and a loss, if any.

The basis of the property to be used will depend on whether you are figuring gain or loss.

Basis for Gain

The basis for gain is your adjusted basis when you sell the property. To figure the adjusted basis, start with your original cost or other basis. Add any improvements or additions you made. Then, subtract depreciation you took or could have taken, casualty losses you claimed on earlier years' returns, and other charges to basis such as amounts you received for easements or rights-of-way.

Adjusted basis is explained earlier, under *Depreciation.*

Basis for Loss

The basis for loss is figured using your adjusted basis at the time of the change or the fair market value at the time of the change, whichever is smaller. Increase the smaller of these amounts by the cost of improvements and additions you made after the change and reduce it by your depreciation and by any casualty loss deductions you claimed after the change. This adjusted amount is your basis for loss.

No Gain or Loss

You will not report a gain or loss on your tax return if you:

Use the ***basis for gain,*** but the result of your figures is a ***loss,*** and

Use the ***basis for loss,*** but the result of your figures is a ***gain.***

Trades

If you trade your property for other property, you may not have a taxable gain or deductible loss. You postpone the gain or loss until you sell or dispose of the property that you received in the trade. The following conditions must be met for the trade to be nontaxable.

1) ***The property must be business or investment property.*** You must hold the property you trade and the property you receive for business or investment purposes. You may not use either property for personal purposes, such as your home or family car.
2) ***The property must be "like kind" property.*** The trade of real estate for real estate and the trade of personal property for similar personal property are trades of like property. The trade of an apartment house for a store building, or a panel truck for a pickup truck, are like kind trades. The trade of a piece of machinery for a store building is not a like kind trade.
3) ***The property must be tangible property.*** These rules and benefits generally do not apply to trades of stocks, bonds, notes, or certain other intangible property.
4) ***The property must not be property held for sale.*** The property you trade and the property you receive must not be property you sell to customers, such as merchandise. It must be property held for use in your business or property held for investment.
5) ***The property you receive must meet identification requirements.*** The property to be received in the trade must be identified on or before the day that is 45 days after the date of transfer of the property you trade.
6) ***The trade must meet the completed transaction requirement.*** The property to be received in the trade must be received before the earlier of:
   a) The 181st day after the date of transfer of the property you trade, or
   b) The due date, including extensions, for your tax return for the tax year in which the property you trade is transferred.

Example. You and another landlord agree to trade rental properties. You agree on which of your apartments you will transfer and you agree that the other landlord can transfer either of his two apartments to you.

On November 1, 1989, you transfer your apartment to the other landlord. You file your tax returns on a calendar year basis.

In order for this to be a nontaxable trade, the following two conditions must be met.

1) The other landlord must identify which apartment will be transferred to you. The identification must be made before December 17, 1989 (see rule (5) above), and
2) The apartment must be transferred to you before May 1, 1990 (see rule (6) above).

If you receive cash or other property in addition to the like-kind property, but otherwise all the above conditions are met, you have a partially nontaxable trade. You are taxed on the gain you realize, but only to the extent of the cash or other property you receive. You cannot deduct a loss.

If you pay cash in addition to the property you give up, there is still no gain or loss if all the above conditions are otherwise met.

Trades between related persons. In addition to the six conditions mentioned before, some additional rules apply to trades of like-kind property between related persons. You generally can postpone gain or loss when you trade property for other property owned by a person related to you. However, if either you or the other person disposes of the property within 2 years after the last transfer that was part of the exchange, then any gain or loss on the exchange is recognized on the date of disposition of the property.

These rules generally do not apply to dispositions due to the death of either related person. Nor do they apply to involuntary conversions, or exchanges or dispositions whose main purpose is not to avoid paying federal income tax.

Related persons. Under these rules related persons include members of your family (spouse, brother, sister, parent, child, etc.) and a corporation of which you own more than 50%. For more information, see *Loss not deductible,* under *Sales and Exchanges Between Related Parties* in Publication 544.

For more information about nontaxable trades, see *Nontaxable Exchanges* in Publication 544, *Sales and Other Dispositions of Assets.*

Recapture of Depreciation

Gain on certain dispositions of depreciable property used in your business or held for the production of rents or royalties may be treated as capital gain. This is explained later under *Section 1231 Gain or Loss.*

However, all or part of any depreciation on the property may be treated as ordinary income under the rules discussed here. This is called recapture of depreciation.

If you have to treat any of the gain as ordinary income, you may consider for capital gain treatment only the part of your gain that is not ordinary income under these rules.

Sales or exchanges which do not result in ordinary income. All of the gain from the sale of some properties is capital gain. You do not have to report any of it as ordinary income. These properties are:

- Property you held for more than one year, if:
  a) You used the straight line method to figure depreciation on the property, or
  b) You used a method of depreciation that resulted in no more depreciation than would have resulted had you used the straight line method,
- Property on which you realize a loss,
- Qualified low-income rental property that you held for 16⅔ years or longer,
- 15–, 18–, or 19–year real property (such as residential rental property) which you depreciated under the alternate ACRS method (see Publication 534, *Depreciation*), and
- Residential rental property or nonresidential real property which you depreciated under the MACRS method.

Personal vs. real property. You use different rules for personal property and real property to figure if part of the gain on disposition is ordinary income.

The classification of property under the headings *Personal Property* and *Real Property,* later, applies only to this discussion. It does not depend on how the property is classified under local law.

Personal Property

Depreciable personal property, for this discussion, includes any property that is or that has been subject to an allowance for depreciation and that is:

1) Personal property, both tangible and intangible,
2) An elevator or an escalator (placed in service before 1987),
3) Real property not included in (5) below, to the extent its adjusted basis reflects amortization deductions for certified pollution control facilities, child care facilities, removal of architectural barriers to the handicapped and elderly, reforestation expenditures, or with respect to which a section 179 deduction was taken,
4) A single purpose agricultural or horticultural structure, or
5) Any other depreciable tangible property that is or that has been an integral part of certain business activities, that is a research facility

used in connection with these activities, or that is a facility used in connection with these activities principally for bulk storage of fungible commodities. These business activities are manufacturing, production, extraction, transportation, communications, and other public utility services. This depreciable tangible property does not include buildings or their structural parts.

This property is called "section 1245" property. Once property qualifies as depreciable personal property, it remains so even though its function may change. A leasehold of any of the property already described is also depreciable personal property.

ACRS property. All property depreciated under the ACRS method is section 1245 recovery property except:

1) 15–year, 18–year, or 19–year real property that is residential rental property,
2) 15–year, 18–year, or 19–year real property that is used mostly outside the U.S.,
3) 15–year, 18–year, or 19–year real property on which the alternate ACRS method is used, and
4) 15–year real property that is low-income housing.

Therefore, section 1245 property includes nonresidential rental property placed in service after 1980 and before 1987. Nonresidential rental property placed in service after 1986 is section 1250 property discussed later under *Real Property*.

Reporting the gain. You must report gain from the sale, exchange, or other disposition of depreciable personal section 1245 property as ordinary income in Part II, Form 4797, to the extent of the depreciation you took or could have taken on the property. Use Part III of Form 4797 to figure your ordinary gain. You report any remaining balance of gain, other than from casualty or theft, in Part I of Form 4797.

Depreciation. You use the depreciation on the property to determine how much of the gain is ordinary income. For this purpose, depreciation includes the following:

Normal depreciation based on useful life, recovery period, or class lives,

Amortization of pollution control facilities, emergency facilities, on-the-job training facilities, child care facilities, and certain expenditures for certified historic structures,

Any deduction for removal of certain barriers to the handicapped or elderly (applicable to tax years after 1976),

Additional first year depreciation (applicable to tax years before 1981),

Amounts deducted under section 179 (applicable to tax years after 1981), and

Any reduction in basis by 50% of the investment credit (applicable to tax years after 1982).

Example. On January 1, 1982, you paid $600 for a new refrigerator for a house that you rent out. On July 1, 1990, you sold the refrigerator for $300. You claimed depreciation on the refrigerator as a 5–year ACRS property and at the end of 1988 the refrigerator was fully depreciated. Your adjusted basis on the date of sale was zero. You figure the gain in Part III of Form 4797. Your gain on the sale is $300 minus zero. You enter the gain on line 24, Part III of Form 4797. Because the gain is less than the total depreciation you claimed, you must include the $300 in your income as ordinary income. Enter the $300 on line 25(b), Part III, and complete the rest of the Form 4797.

Real Property

Depreciable real property includes all real property that is subject to an allowance for depreciation and is not or has not been section 1245 property at any time. It also includes leased property to which the lessee has made improvements that are subject to an allowance for depreciation, such as a building, and the cost of getting a lease. A fee simple interest in land is not included because it is not depreciable. This property is called "section 1250" property.

If, as a result of a change in its use, you reclassify section 1250 property as section 1245 property, you may never again consider it section 1250 property.

Ordinary income part. To figure what part of your gain is ordinary income, you must use the following steps:

1) In a sale, exchange, or involuntary conversion of the property, subtract the adjusted basis of the property from the amount realized. In any other disposition of the property, subtract the adjusted basis from the fair market value,
2) Figure the ***additional depreciation,*** explained later, for periods after 1975, and
3) Multiply the smaller of (1) or (2) by the ***applicable percentage,*** explained later.

If any gain remains, that is, if (1) is more than (2), you must:

4) Figure the ***additional depreciation*** for periods after 1969 and before 1976,
5) Multiply the smaller of the remaining gain ((1) minus (2) or (4)) by the ***applicable percentage,*** and
6) Add (3) and (5) to figure the amount of gain you must report as ordinary income.

You use lines 26(a) through 26(g), Part III of Form 4797, to figure your ordinary income.

Additional depreciation. If you hold section 1250 property for more than one year, you figure the additional depreciation by subtracting depreciation figured under the straight line method from the actual depreciation for the same period. Thus, you will have additional depreciation if you use the declining balance method, the sum of the years' digits method, regular ACRS, or any other method of rapid depreciation.

If you hold depreciable real property for one year or less, all of the depreciation is additional depreciation.

You use the same recovery period or useful life and salvage value to figure depreciation under the straight line method as that used under the depreciation method you actually employed.

Applicable percentage. You may have to use two applicable percentages to figure the gain that is taxable as ordinary income. The applicable percentage that you use for the period after 1969 and before 1976 may be different than the one you use for the period after 1975. The applicable percentages for each of these periods are as follows.

For the period ***after 1969 and before 1976,*** the applicable percentage is 100%, except in the following cases:

1) For certain governmentally insured or assisted low-income rental housing, the applicable percentage is 100% minus 1% for each full month the property was held for more than 20 months.
2) For rehabilitated low-income rental housing that was allowed the special 60–month depreciation for rehabilitation expenses, the applicable percentage is 100% minus 1% for each full month the property was held for more than 100 months after the property was placed in service.
3) For other residential rental property, 80% or more of the gross rental income of which is from dwelling units, the applicable percentage is 100% minus 1% for each full month the property was held for more than 100 months.

When property in (1) has been held for at least 10 years, and when property in (2) and (3) has been held for at least 16⅔ years, the applicable percentage is zero. At those times you will no longer have ordinary income because of additional depreciation for the period after 1969 and before 1976.

For the period ***after 1975,*** the applicable percentage is 100%, except in the following cases:

1) For certain governmentally insured, assisted, or subsidized low-income rental housing, the applicable percentage is 100% minus 1% for each full month the property was held for more than 100 months.
2) For rehabilitated low-income rental housing that was allowed the special 60–month depreciation for rehabilitation expenses, the applicable percentage is 100% minus 1% for each full month the property was held for more than 100 months after the property was placed in service.

If you dispose of real property because of a ***foreclosure*** or similar proceeding that began after 1975, you figure the applicable percentage as if you had stopped holding the property on the date the proceeding began.

To figure the applicable percentage when it is less than 100%, the ***holding period*** for property generally begins on the day after you get it.

If you construct or reconstruct property, the holding period begins on the first day of the month in which it is placed in service in a trade or business, in the production of income, or in a personal activity.

If you get depreciable real property by gift or in a tax-free exchange, the basis of which is determined by reference to the basis in the hands of the transferor, the holding period includes the holding period of the transferor.

Permanent Records

You must keep permanent records in order to figure the gain you must report as ordinary income. These records should include the date and the manner in which you acquired the property, the cost or other basis of the property on that date, how you figured that basis, the depreciation you took or could have taken, and all other adjustments that increase or reduce your basis.

In addition, if you have property that has an adjusted basis reflecting depreciation or amortization taken by you on other property (such as property you received in a nontaxable trade), or by another person on the same or other property (as in the case of property you received as a gift), your records must show this information.

Section 1231 Gain or Loss

If you dispose of depreciable property, you first figure the ordinary gain, as discussed above. You include any remaining gain with your other "section 1231" gains and losses.

Section 1231 property. This property includes property used in a trade or business or held for the production of rents or royalties and any other property (including capital assets held in connection with a trade or business or a transaction entered into for profit) held more than 1 year that is subjected to an involuntary conversion. In a disposition of depreciable property, any ordinary gain that is from the deduction of depreciation is figured first. Any remaining gain is included in the section 1231 computation in Part I of Form 4797.

Any of the following may give you gain (after subtracting any ordinary gain) or loss from section 1231 property.

Sales and exchanges of real property or depreciable personal property you used in a trade or business and held for more than 1 year.

Sales and exchanges of property you held for the production of rents or royalties and held for more than 1 year.

Sales and exchanges of leaseholds used in a trade or business and held for more than 1 year.

- Condemnations (taking private property for public use), if the property was held for more than 1 year. This includes business property and capital assets such as investment property.
- Casualties and thefts of property held for more than 1 year. This includes casualties and thefts of business property, property held for the production of rents or royalties, and investment property. You must consider insurance proceeds or other reimbursements in figuring your net gain or loss.

Net Section 1231 Gain or Loss

Net section 1231 gain for the year is the excess of section 1231 gains over section 1231 losses. Net section 1231 loss for the year is the excess of section 1231 losses over section 1231 gains.

You must treat as ordinary income that part of your net section 1231 gain for 1990 that equals the total of your net section 1231 losses for 1985, 1986, 1987, 1988, and 1989 that were not treated as ordinary income after 1984.

Section 1231 gains and losses do not include recognized gains and losses from casualties or thefts affecting capital assets held for more than one year and held in connection with a trade or business or any property used in a trade or business if the recognized losses from those casualties and thefts for the year exceed the recognized gains in the same year from casualties or thefts affecting the same types of property.

The part, if any, of your net section 1231 gain for 1990 that is not treated as ordinary income is treated as long-term capital gain.

If you have a net section 1231 loss for 1990, or if your section 1231 gains and losses for 1990 are equal, you treat all of your section 1231 gains and losses as ordinary gains and losses.

Form 4797. You use Form 4797, *Sales of Business Property,* to report the above items and to figure your ordinary or capital gain or loss.

Example 1. On September 1, 1975, Jack White bought new property to use as rental property. The property cost $50,000, of which $40,000 was for the house and $10,000 was for the land. On January 4, 1990, he sold the property for $75,000, of which $60,000 was for the house and $15,000 was for the land. During the years Jack owned the property, he claimed $20,820 depreciation using the declining balance method. He figures his additional depreciation as follows:

	Depreciation claimed	Straight line depreciation	Additional depreciation
1975	$ 667	$ 333	$ 334
Additional depreciation after 1969 and before 1976			$334
1976	$1,967	$1,000	$ 967
1977	1,868	1,000	868
1978	1,775	1,000	775
1979	1,686	1,000	686
1980	1,602	1,000	602
1981	1,522	1,000	522
1982	1,446	1,000	446
1983	1,373	1,000	373
1984	1,305	1,000	305
1985	1,240	1,000	240
1986	1,177	1,000	177
1987	1,119	1,000	119
1988	1,063	1,000	63
1989	1,010	1,000	10
Additional depreciation after 1975			$6,153

The applicable percentage Jack uses for additional depreciation after 1969 and before 1976 is 28% (100% minus 72%; he held the property for 172 months). The applicable percentage for additional depreciation after 1975 is 100%.

Jack figures the gain he must report as ordinary income as follows:

1) Gross sales price		$60,000	
2) Cost	$40,000		
3) Minus: Depreciation	20,820		
4) Adjusted basis (line 2 minus line 3)		19,180	
5) Gain (line 1 minus line 4)		$40,820	
6) Additional depreciation after 1975		6,153	
7) Applicable percentage (100%) times the smaller of line 5 or line 6			$6,153
8) Line 5 minus line 6		$34,667	
9) Additional depreciation after 1969 and before 1976		$ 334	
10) Applicable percentage (28%) times the smaller of line 8 or line 9			94
11) **Gain reported as ordinary income** (line 7 plus line 10)			$6,247

Jack has a net section 1231 gain for 1990 of $39,573 ($5,000 gain on the land plus $40,820 gain on the house, reduced by $6,247 gain reported as ordinary income). This is Jack's only section 1231 gain or loss during 1990.

In 1985, Jack had a net section 1231 loss of $3,125 from the sale of rental property. He did not have any net section 1231 gains or losses in 1986, 1987, 1988, or 1989. He must treat $3,125 of his net section 1231 gain for 1990 ($39,573) as ordinary income. He treats the balance ($36,448) as long-term capital gain.

Jack enters $9,372 ($6,247 plus $3,125) on line 18b(2), Part II of Form 4797, and on line 15, Form 1040.

He enters the balance of the gain ($36,448) on line 9, Part I of Form 4797, and as a long-term capital gain on Schedule D.

Jack's Form 4797 is shown at the end of this publication.

Example 2. On July 1, 1981, Peter Rivers bought a new apartment to use as rental property. He paid $60,000 for the property, of which $58,000 was for the apartment and $2,000 was for the land. On January 2, 1990, Peter sold the property for $80,000, of which $76,000 was for the apartment and $4,000 was for the land. He paid $4,800 in selling expenses ($4,560 for the apartment and $240 for the land). During the years Peter owned the property, he claimed $38,860 in depreciation using the ACRS method of depreciation. Peter's only sources of income in 1990 were salaries of $75,000 and the gain from the sale of the rental apartment. He is 39 years old, single, has no dependents and does not itemize deductions.

In 1990, Peter's federal income tax withheld was $17,725. He also paid $17,500 in estimated tax.

The apartment is 15-year real property. Peter figures his additional depreciation as follows:

	Depreciation claimed	Straight line depreciation	Additional depreciation
1981	$3,480	$1,933	$1,547
1982	6,380	3,867	2,513
1983	5,800	3,867	1,933
1984	5,220	3,867	1,353
1985	4,640	3,867	773
1986	4,060	3,867	193
1987	3,480	3,867	(387)
1988	2,900	3,867	(967)
1989	2,900	3,867	(967)
Additional depreciation			$5,991

The application percentage Peter uses for additional depreciation is 100% because he acquired his property after 1975. He figures the gain he must report as ordinary income as follows:

1) Gross sales price			$76,000
2) Cost	$58,000		
Plus expense of sale	4,560		
	$62,560		
3) Minus depreciation	38,860		
4) Adjusted basis (line 2 minus line 3)		23,700	
5) Gain (line 1 minus line 4)		$52,300	
6) Additional depreciation		5,991	
7) Applicable percentage (100%) multiply by the smaller of line 5 or line 6			$5,991
8) Line 5 minus line 6		$46,309	
9) **Gain reported as ordinary income** (line 7)			$5,991

Peter's net section 1231 gain for 1990 is $48,069 ($1,760 gain on the land plus $52,300 gain on the apartment, reduced by $5,991 reported as ordinary income). This is Peter's only section 1231 gain or loss during 1990. He did not have any net section 1231 gains or losses in previous years.

Peter enters $48,069 on line 7, Part I of Form 4797, and as long-term capital gain on Schedule D, line 14. He also enters $5,991 on line 18b(2), Part II of Form 4797, and as ordinary gain on Form 1040, line 15. Peter's Form 1040, Schedule D, and Form 4797 are shown at the end of this publication.

Sale or Exchange of Your Main Home

The depreciation recapture rules do not apply to the sale or other disposition of your property to the extent you used it as your main home. If you used your home for business or for rental purposes, and if you postpone the gain on the sale or exchange, you must carry over the depreciation adjustments and the additional depreciation to the new home. Postponing gain on the sale of your main home is discussed in Publication 523, *Tax Information on Selling Your Home.*

Exclusion of Gain

If you can exclude all or part of the gain on the sale of your home because you were 55 or older by the date of the sale and met certain ownership and use requirements, you do not have to report any of the gain as ordinary income. It does not matter whether you used all or part of the property in your business or for rental purposes during vacations or other seasonal absences. This rule applies even though you do not choose to exclude the gain as explained in Publication 523. You may have ordinary income, however, if only part of your home qualified as your main home.

Form **4797**

Department of the Treasury
Internal Revenue Service

Sales of Business Property

(Also, Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F)

▶ Attach to your tax return. ▶ See separate instructions.

OMB No. 1545-0184

1990

Attachment Sequence No. 27

Name(s) shown on return: Jack B. White

Identifying number: 917-00-6543

Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty and Theft—Property Held More Than 1 Year

1 Enter here the gross proceeds from the sale or exchange of real estate reported to you for 1990 on Form(s) 1099-S (or a substitute statement) that you will be including on line 2, 10, or 20 — 1 **75,000**

(a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	(g) LOSS ((f) minus the sum of (d) and (e))	(h) GAIN ((d) plus (e) minus (f))
2 Land	9-1-75	1-4-90	15,000		10,000		5,000

3 Gain, if any, from Form 4684, Section B, line 21		
4 Section 1231 gain from installment sales from Form 6252, line 22 or 30		34,573
5 Gain, if any, from line 32, from other than casualty and theft	( )	34,573
6 Add lines 2 through 5 in column (g) and (h)		39,573

7 Combine columns (g) and (h) of line 6. Enter gain or (loss) here, and on the appropriate line as follows:

Partnerships.—Enter the gain or (loss) on Form 1065, Schedule K, line 6. Skip lines 8, 9, 11, and 12 below.

S corporations.—Report the gain or (loss) following the instructions for Form 1120S, Schedule K, lines 5 and 6. Skip lines 8, 9, 11, and 12 below, unless line 7 is a gain and the S corporation is subject to the capital gains tax.

All others.—If line 7 is zero or a loss, enter the amount on line 11 below and skip lines 8 and 9. If line 7 is a gain and you did not have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain as a long-term capital gain on Schedule D and skip lines 8, 9, and 12 below.

8 Nonrecaptured net section 1231 losses from prior years (see instructions)	3,125
9 Subtract line 8 from line 7. If zero or less, enter -0-. Also enter on the appropriate line as follows (see instructions)	36,448

S corporations.—Enter this amount (if greater than zero) on Form 1120S, Schedule D, line 7, and skip lines 11 and 12 below.

All others.—If line 9 is zero, enter the amount from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below, and enter the amount from line 9 as a long-term capital gain on Schedule D.

Part II Ordinary Gains and Losses

10 Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less):

11 Loss, if any, from line 7		
12 Gain, if any, from line 7 or amount from line 8 if applicable		3,125
13 Gain, if any, from line 31		6,247
14 Net gain or (loss) from Form 4684, Section B, lines 13 and 20a		
15 Ordinary gain from installment sales from Form 6252, line 21 or 29		
16 Recapture of section 179 deduction for partners and S corporation shareholders from property dispositions by partnerships and S corporations (see instructions)	( )	9,372
17 Add lines 10 through 16 in columns (g) and (h)		9,372

18 Combine columns (g) and (h) of line 17. Enter gain or (loss) here, and on the appropriate line as follows:

a For all except individual returns. Enter the gain or (loss) from line 18 on the return being filed.

b For individual returns:

(1) If the loss on line 11 includes a loss from Form 4684, Section B, Part II, column (b)(ii), enter that part of the loss here and on line 21 of Schedule A (Form 1040). Identify as from "Form 4797, line 18b(1)." See instructions.

(2) Redetermine the gain or (loss) on line 18, excluding the loss, if any, on line 18b(1). Enter here and on Form 1040, line 15 — **9,372**

Part III Gain From Disposition of Property Under Sections 1245, 1250, 1252, 1254, and 1255

19 Description of section 1245, 1250, 1252, 1254, and 1255 property:

		Date acquired (mo., day, yr.)	Date sold (mo., day, yr.)
A	Brick House - Rental Property	9-1-75	1-4-90
B			
C			
D			

Relate lines 19A through 19D to these columns ▶	Property A	Property B	Property C	Property D
20 Gross sales price (Note: See line 1 before completing.)	60,000			
21 Cost or other basis plus expense of sale	40,000			
22 Depreciation (or depletion) allowed or allowable	20,820			
23 Adjusted basis. Subtract line 22 from line 21	19,180			
24 Total gain. Subtract line 23 from line 20	40,820			
25 If section 1245 property:				
a Depreciation allowed or allowable from line 22				
b Enter the smaller of line 24 or 25a				
26 If section 1250 property: If straight line depreciation was used, enter zero on line 26g unless you are a corporation subject to section 291.				
a Additional depreciation after 12/31/75 (see instructions)	6,153			
b Applicable percentage multiplied by the smaller of line 24 or line 26a (see instructions)	6,153			
c Subtract line 26a from line 24. If line 24 is not more than line 26a, skip lines 26d and 26e	34,667			
d Additional depreciation after 12/31/69 and before 1/1/76	334			
e Applicable percentage multiplied by the smaller of line 26c or 26d (see instructions)	94			
f Section 291 amount (corporations only)				
g Add lines 26b, 26e, and 26f	6,247			
27 If section 1252 property: Skip this section if you did not dispose of farmland or if you are a partnership.				
a Soil, water, and land clearing expenses				
b Line 27a multiplied by applicable percentage (see instructions)				
c Enter the smaller of line 24 or 27b				
28 If section 1254 property:				
a Intangible drilling and development costs, expenditures for development of mines and other natural deposits, and mining exploration costs (see instructions)				
b Enter the smaller of line 24 or 28a				
29 If section 1255 property:				
a Applicable percentage of payments excluded from income under section 126 (see instructions)				
b Enter the smaller of line 24 or 29a				

Summary of Part III Gains (Complete property columns A through D, through line 29b before going to line 30.)

30 Total gains for all properties. Add columns A through D, line 24	40,820
31 Add columns A through D, lines 25b, 26g, 27c, 28b, and 29b. Enter here and on line 13. (See the instructions for Part IV if this is an installment sale.)	6,247
32 Subtract line 31 from line 30. Enter the portion from casualty and theft on Form 4684, Section B, line 15. Enter the portion from other than casualty and theft on Form 4797, line 5	34,573

Part IV Election Not to Use the Installment Method (Complete this part only if you elect out of the installment method and report a note or other obligation at less than full face value.)

33 Check here if you elect out of the installment method	▶ ☐
34 Enter the face amount of the note or other obligation	▶ $
35 Enter the percentage of valuation of the note or other obligation	▶ %

Part V Recapture Amounts Under Sections 179 and 280F When Business Use Drops to 50% or Less (See instructions for Part V.)

	(a) Section 179	(b) Section 280F
36 Section 179 expense deduction or section 280F recovery deductions		
37 Depreciation or recovery deductions (see instructions)		
38 Recapture amount. Subtract line 37 from line 36. (See instructions for where to report.)		

1040 U.S. Individual Income Tax Return 1990

Department of the Treasury—Internal Revenue Service

For the year Jan.–Dec. 31, 1990, or other tax year beginning ____, 1990, ending ____, 19____ OMB No. 1545-0074

Label (See instructions on page 8.) Use IRS label. Otherwise, please print or type.

Your first name and initial: Peter U. | Last name: Rivers | Your social security number: 575 : 00 : 1111

If a joint return, spouse's first name and initial | Last name | Spouse's social security number

Home address (number and street). (If you have a P.O. box, see page 8.): 1040 Flagler Ave. | Apt. no.

City, town or post office, state and ZIP code. (If you have a foreign address, see page 8.): Hometown, FL 33333

For Privacy Act and Paperwork Reduction Act Notice, see instructions.

Presidential Election Campaign (See page 9.)

Do you want $1 to go to this fund? ✓ Yes ☐ No

If joint return, does your spouse want $1 to go to this fund? ☐ Yes ☐ No

Note: Checking "Yes" will not change your tax or reduce your refund.

Filing Status Check only one box.

1 ✓ Single. (See page 9 to find out if you can file as head of household.)
2 ☐ Married filing joint return (even if only one had income)
3 ☐ Married filing separate return. Enter spouse's social security no. above and full name here. ▶ ____
4 ☐ Head of household (with qualifying person). (See page 9.) If the qualifying person is your child but not your dependent, enter this child's name here. ▶ ____
5 ☐ Qualifying widow(er) with dependent child (year spouse died ▶ 19__). (See page 9.)

Exemptions (See instructions on page 10.)

6a ✓ Yourself. If your parent (or someone else) can claim you as a dependent on his or her tax return, do not check box 6a. But be sure to check the box on line 33b on page 2 — No. of boxes checked on 6a and 6b: 1

b ☐ Spouse

c Dependents:

(1) Name (first, initial, and last name)	(2) Check if under age 7	(3) If age 2 or older, dependent's social security number	(4) Relationship	(5) No. of months lived in your home in 1990

If more than 6 dependents, see instructions on page 11.

No. of your children on 6c who: • lived with you ____ • didn't live with you due to divorce or separation (see page 11) ____

No. of other dependents on 6c ____

d If your child didn't live with you but is claimed as your dependent under a pre-1985 agreement, check here ▶ ☐

Add numbers entered on lines above ▶ 1

e Total number of exemptions claimed

Income Attach Copy B of your Forms W-2, W-2G, and W-2P here. If you do not have a W-2, see page 8. Attach check or money order on top of any Forms W-2, W-2G, and W-2P.

7	Wages, salaries, tips, etc. (attach Form(s) W-2)	7	75,000
8a	Taxable interest income (also attach Schedule B if over $400)	8a	
b	Tax-exempt interest income (see page 13). DON'T include on line 8a. 8b		
9	Dividend income (also attach Schedule B if over $400)	9	
10	Taxable refunds of state and local income taxes, if any, from worksheet on page 14	10	
11	Alimony received	11	
12	Business income or (loss) (attach Schedule C)	12	
13	Capital gain or (loss) (attach Schedule D)	13	47,069
14	Capital gain distributions not reported on line 13 (see page 14)	14	
15	Other gains or (losses) (attach Form 4797)	15	5,991
16a	Total IRA distributions 16a	b Taxable amount (see page 14)	16b	
17a	Total pensions and annuities 17a	b Taxable amount (see page 14)	17b	
18	Rents, royalties, partnerships, estates, trusts, etc. (attach Schedule E)	18	
19	Farm income or (loss) (attach Schedule F)	19	
20	Unemployment compensation (insurance) (see page 16)	20	
21a	Social security benefits 21a	b Taxable amount (see page 16)	21b	
22	Other income (list type and amount—see page 16)	22	
23	Add the amounts shown in the far right column for lines 7 through 22. This is your total income ▶	23	129,060

Adjustments to Income (See instructions on page 16.)

24a	Your IRA deduction, from applicable worksheet on page 17 or 18	24a	
b	Spouse's IRA deduction, from applicable worksheet on page 17 or 18	24b	
25	Deduction for self-employment tax, from worksheet on page 18	25	
26	Self-employed health insurance deduction, from worksheet on page 18	26	
27	Keogh retirement plan and self-employed SEP deduction	27	
28	Penalty on early withdrawal of savings	28	
29	Alimony paid. Recipient's SSN ▶	29	
30	Add lines 24a through 29. These are your total adjustments ▶	30	

Adjusted Gross Income

31	Subtract line 30 from line 23. This is your adjusted gross income. If this amount is less than $20,264 and a child lived with you, see page 23 to find out if you can claim the "Earned Income Credit" on line 57 ▶	31	129,060

Form 1040 (1990) Page 2

Tax Computation If you want IRS to figure your tax, see Instructions on page 19.

32	Amount from line 31 (adjusted gross income)	32	129,060
33a	Check if: ☐ You were 65 or older ☐ Blind; ☐ Spouse was 65 or older ☐ Blind. Add the number of boxes checked and enter the total here ▶ 33a		
b	If your parent (or someone else) can claim you as a dependent, check here ▶ 33b ☐		
c	If you are married filing a separate return and your spouse itemizes deductions, or you are a dual-status alien, see page 19 and check here ▶ 33c ☐		
34	Enter the larger of: • Your standard deduction (from applicable chart (or worksheet) on page 20). OR • Your itemized deductions (from Schedule A, line 27). If you itemize, attach Schedule A and check here ▶ ☐	34	3,250
35	Subtract line 34 from line 32	35	125,810
36	Multiply $2,050 by the total number of exemptions claimed on line 6e	36	2,050
37	Taxable income. Subtract line 36 from line 35. (If line 36 is more than line 35, enter -0-.)	37	123,760
38	Enter tax. Check if from: a ☐ Tax Table; b ☒ Tax Rate Schedules; or c ☐ Form 8615 (see page 21). (If any is from Form(s) 8814, enter that amount here ▶ ____.)	38	35,227
39	Additional taxes (see page 21). Check if from: a ☐ Form 4970 b ☐ Form 4972	39	-
40	Add lines 38 and 39 ▶	40	35,227

Credits (See Instructions on page 21.)

41	Credit for child and dependent care expenses (attach Form 2441)	41		
42	Credit for the elderly or the disabled (attach Schedule R)	42		
43	Foreign tax credit (attach Form 1116)	43		
44	General business credit. Check if from: a ☐ Form 3800 or b ☐ Form (specify): ____	44		
45	Credit for prior year minimum tax (attach Form 8801)	45		
46	Add lines 41 through 45			46
47	Subtract line 46 from line 40. (If line 46 is more than line 40, enter -0-.) ▶			47 35,227

Other Taxes

48	Self-employment tax (attach Schedule SE)	48	
49	Alternative minimum tax (attach Form 6251)	49	
50	Recapture taxes (see page 22). Check if from: a ☐ Form 4255 b ☐ Form 8611	50	
51	Social security tax on tip income not reported to employer (attach Form 4137)	51	
52	Tax on an IRA or a qualified retirement plan (attach Form 5329)	52	
53	Advance earned income credit payments, from Form W-2	53	
54	Add lines 47 through 53. This is your total tax ▶	54	35,227

Payments Attach Forms W-2, W-2G, and W-2P to front.

55	Federal income tax withheld (If any is from Form(s) 1099, check ▶ ☐)	55	17,725	
56	1990 estimated tax payments and amount applied from 1989 return	56	17,500	
57	Earned income credit (see page 23)	57		
58	Amount paid with Form 4868 (extension request)	58		
59	Excess social security tax and RRTA tax withheld (see page 24)	59		
60	Credit for Federal tax on fuels (attach Form 4136)	60		
61	Regulated investment company credit (attach Form 2439)	61		
62	Add lines 55 through 61. These are your total payments ▶			62 35,225

Refund or Amount You Owe

63	If line 62 is more than line 54, enter amount OVERPAID ▶	63	
64	Amount of line 63 to be REFUNDED TO YOU ▶	64	
65	Amount of line 63 to be APPLIED TO YOUR 1991 ESTIMATED TAX ▶ 65		
66	If line 54 is more than line 62, enter AMOUNT YOU OWE. Attach check or money order for full amount payable to "Internal Revenue Service." Write your name, social security number, address, daytime phone number, and "1990 Form 1040" on it	66	2
67	Estimated tax penalty (see page 25) 67		

Sign Here (Keep a copy of this return for your records.)

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Your signature: Peter U. Rivers | Date: 3-17-91 | Your occupation: Salesman

Spouse's signature (if joint return, BOTH must sign) | Date | Spouse's occupation

Paid Preparer's Use Only

Preparer's signature | Date | Check if self-employed ☐ | Preparer's social security no.

Firm's name (or yours if self-employed) and address | E.I. No. | ZIP code

SCHEDULE D (Form 1040)

Department of the Treasury Internal Revenue Service

Capital Gains and Losses

(And Reconciliation of Forms 1099-B for Bartering Transactions)

▶ Attach to Form 1040. ▶ See Instructions for Schedule D (Form 1040).

▶ For more space to list transactions for lines 2a and 9a, get Schedule D-1 (Form 1040).

OMB No. 1545-0074

1990

Attachment Sequence No. 12A

Name(s) shown on Form 1040: Peter U. Rivers

Your social security number: 575 00 1111

1 Enter the total sales of stocks, bonds, etc., and real estate transactions reported to you for 1990 on Forms 1099-B and 1099-S or on an equivalent substitute statement(s). If this amount differs from the total of lines 2c and 9c, column (d), attach a statement explaining the difference. See line 1 instructions for examples . . . 1

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less

(a) Description of property (Example, 100 shares 7% preferred of "Z" Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see instructions)	(e) Cost or other basis (see instructions)	(f) LOSS If (e) is more than (d), subtract (d) from (e)	(g) GAIN If (d) is more than (e), subtract (e) from (d)
2a Stocks, Bonds, Other Securities, And Real Estate. Include All Form 1099-B And 1099-S Transactions. See Instructions.						
2b Amounts from Schedule D-1, line 2b (attach Schedule D-1)						
2c **Total of All Sales Price Amounts** (add column (d) of lines 2a and 2b) ▶ 2c						
2d Other Transactions (Do NOT include real estate transactions from Forms 1099-S. Report them on line 2a.)						
3 Short-term gain from sale or exchange of your home from Form 2119, line 10 or 14c				3		
4 Short-term gain from installment sales from Form 6252, line 22 or 30				4		
5 Net short-term gain or (loss) from partnerships, S corporations, and fiduciaries				5		
6 Short-term capital loss carryover from 1989 Schedule D, line 29				6		
7 Add lines 2a, 2b, 2d, and 3 through 6, in columns (f) and (g)				7	( )	
8 **Net short-term gain or (loss).** Combine columns (f) and (g) of line 7					8	

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year

(a) Description of property (Example, 100 shares 7% preferred of "Z" Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see instructions)	(e) Cost or other basis (see instructions)	(f) LOSS If (e) is more than (d), subtract (d) from (e)	(g) GAIN If (d) is more than (e), subtract (e) from (d)
9a Stocks, Bonds, Other Securities, And Real Estate. Include All Form 1099-B And 1099-S Transactions. See Instructions.						
9b Amounts from Schedule D-1, line 9b (attach Schedule D-1)						
9c **Total of All Sales Price Amounts** (add column (d) of lines 9a and 9b) ▶ 9c						
9d Other Transactions (Do NOT include real estate transactions from Forms 1099-S. Report them on line 9a.)						
10 Long-term gain from sale or exchange of your home from Form 2119, line 10 or 14c				10		
11 Long-term gain from installment sales from Form 6252, line 22 or 30				11		
12 Net long-term gain or (loss) from partnerships, S corporations, and fiduciaries				12		
13 Capital gain distributions				13		
14 Gain from Form 4797, line 7 or 9				14		48,069
15 Long-term capital loss carryover from 1989 Schedule D, line 36				15		
16 Add lines 9a, 9b, 9d, and 10 through 15, in columns (f) and (g)				16	( )	48,069
17 **Net long-term gain or (loss).** Combine columns (f) and (g) of line 16					17	48,069

For Paperwork Reduction Act Notice, see Form 1040 Instructions. Schedule D (Form 1040) 1990

Schedule D (Form 1040) 1990 Attachment Sequence No. 12A Page 2

Name(s) shown on Form 1040. (Do not enter name and social security number if shown on other side.) Your social security number

Part III Summary of Parts I and II

18	Combine lines 8 and 17, and enter the net gain or (loss) here. If the result is a gain, **stop here and also enter the gain on Form 1040, line 13**	18 48,069
19	If line 18 is a (loss), enter here and as a (loss) on Form 1040, line 13, the **smaller** of:	
a	The (loss) on line 18; or	
b	($3,000) or, if married filing a separate return, ($1,500)	19 ( )
	Note: *When figuring whether 19a or 19b is smaller, treat both numbers as if they are positive.* Go on to Part IV if the loss on line 18 is more than $3,000 ($1,500, if married filing a separate return). OR if taxable income on Form 1040, line 37, is zero.	

Part IV Capital Loss Carryovers from 1990 to 1991

Section A.—Carryover Limit

20	Enter taxable income from Form 1040, line 37. **(If Form 1040, line 37, is zero, see instructions for amount to enter.)**	20	
	Note: *For lines 21 through 36, enter all amounts as positive numbers.*		
21	Enter the loss on line 19	21	-
22	Enter the amount on Form 1040, line 36	22	
23	Combine lines 20, 21, and 22. If zero or less, enter -0-	23	
24	**Carryover Limit.** Enter the **smaller** of line 21 or line 23	24	

Section B.—Short-Term Capital Loss Carryover to 1991

(Complete this section only if there is a loss on line 8 and line 19. Otherwise, go on to Section C.)

25	Enter the loss on line 8			25
26	Enter the gain, if any, on line 17	26		
27	Enter the amount on line 24	27		
28	Add lines 26 and 27		28	
29	**Short-term capital loss carryover to 1991.** Subtract line 28 from line 25. If zero or less, enter -0-			29

Section C.—Long-Term Capital Loss Carryover to 1991

(Complete this section only if there is a loss on line 17 and line 19.)

30	Enter the loss on line 17			30
31	Enter the gain, if any, on line 8			31
32	Enter the amount on line 24	32		
33	Enter the amount, if any, on line 25	33		
34	Subtract line 33 from line 32. If zero or less, enter -0-			34
35	Add lines 31 and 34			35
36	**Long-term capital loss carryover to 1991.** Subtract line 35 from line 30. If zero or less, enter -0-			36

Part V Election Not to Use the Installment Method (Complete this part only if you elect out of the installment method and report a note or other obligation at less than full face value.)

37	Check here if you elect out of the installment method	▶ ☐
38	Enter the face amount of the note or other obligation	▶
39	Enter the percentage of valuation of the note or other obligation	▶

Part VI Reconciliation of Forms 1099-B for Bartering Transactions

(Complete this part if you received one or more Forms 1099-B or equivalent substitute statements reporting bartering income.)

		Amount of bartering income from Form 1099-B or equivalent statement reported on form or schedule
40	Form 1040, line 22	40
41	Schedule C (Form 1040)	41
42	Schedule D (Form 1040)	42
43	Schedule E (Form 1040)	43
44	Schedule F (Form 1040)	44
45	Other form or schedule (identify) (if nontaxable, indicate reason—attach additional sheets if necessary):	45
46	Total (add lines 40 through 45)	46
	Note: *The amount on line 46 should be the same as the total bartering income on all Forms 1099-B and equivalent statements received for bartering transactions.*	

Form **4797**

Department of the Treasury
Internal Revenue Service

Sales of Business Property

(Also, Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F)

▶ Attach to your tax return. ▶ See separate instructions.

OMB No. 1545-0184

1990

Attachment Sequence No. 27

Name(s) shown on return: Peter W. Rivers

Identifying number: 575-00-1111

Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty and Theft—Property Held More Than 1 Year

1 Enter here the gross proceeds from the sale or exchange of real estate reported to you for 1990 on Form(s) 1099-S (or a substitute statement) that you will be including on line 2, 10, or 20 — 1 — 80,000

(a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	(g) LOSS ((f) minus the sum of (d) and (e))	(h) GAIN ((d) plus (e) minus (f))
2 LAND	7-1-81	1-2-90	4,000		2,240		1,760

3 Gain, if any, from Form 4684, Section B, line 21		
4 Section 1231 gain from installment sales from Form 6252, line 22 or 30		
5 Gain, if any, from line 32, from other than casualty and theft		46,309
6 Add lines 2 through 5 in columns (g) and (h)	( )	48,069
7 Combine columns (g) and (h) of line 6. Enter gain or (loss) here, and on the appropriate line as follows:		48,069

Partnerships.—Enter the gain or (loss) on Form 1065, Schedule K, line 6. Skip lines 8, 9, 11, and 12 below.

S corporations.—Report the gain or (loss) following the instructions for Form 1120S, Schedule K, lines 5 and 6. Skip lines 8, 9, 11, and 12 below, unless line 7 is a gain and the S corporation is subject to the capital gains tax.

All others.—If line 7 is zero or a loss, enter the amount on line 11 below and skip lines 8 and 9. If line 7 is a gain and you did not have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain as a long-term capital gain on Schedule D and skip lines 8, 9, and 12 below.

8 Nonrecaptured net section 1231 losses from prior years (see instructions)		
9 Subtract line 8 from line 7. If zero or less, enter -0-. Also enter on the appropriate line as follows (see instructions):		

S corporations.—Enter this amount (if greater than zero) on Form 1120S, Schedule D, line 7, and skip lines 11 and 12 below.

All others.—If line 9 is zero, enter the amount from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below, and enter the amount from line 9 as a long-term capital gain on Schedule D.

Part II Ordinary Gains and Losses

10 Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less):

11 Loss, if any, from line 7		
12 Gain, if any, from line 7, or amount from line 8 if applicable		5,991
13 Gain, if any, from line 31		
14 Net gain or (loss) from Form 4684, Section B, lines 13 and 20a		
15 Ordinary gain from installment sales from Form 6252, line 21 or 29		
16 Recapture of section 179 deduction for partners and S corporation shareholders from property dispositions by partnerships and S corporations (see instructions)	( )	5,991
17 Add lines 10 through 16 in columns (g) and (h)		5,991
18 Combine columns (g) and (h) of line 17. Enter gain or (loss) here, and on the appropriate line as follows:		
a For all except individual returns: Enter the gain or (loss) from line 18 on the return being filed.		
b For individual returns:		
(1) If the loss on line 11 includes a loss from Form 4684, Section B, Part II, column (b)(ii), enter that part of the loss here and on line 21 of Schedule A (Form 1040). Identify as from "Form 4797, line 18b(1)." See instructions		
(2) Redetermine the gain or (loss) on line 18, excluding the loss, if any, on line 18b(1). Enter here and on Form 1040, line 15		5,991

Part III Gain From Disposition of Property Under Sections 1245, 1250, 1252, 1254, and 1255

19 Description of section 1245, 1250, 1252, 1254, and 1255 property:	Date acquired (mo., day, yr.)	Date sold (mo., day, yr.)
A Apartment - Rental Property	7-1-81	1-2-90
B		
C		
D		

Relate lines 19A through 19D to these columns ▶	Property A	Property B	Property C	Property D
20 Gross sales price (Note: See line 1 before completing.)	76,000			
21 Cost or other basis plus expense of sale	62,560			
22 Depreciation (or depletion) allowed or allowable	38,960			
23 Adjusted basis. Subtract line 22 from line 21	23,700			
24 Total gain. Subtract line 23 from line 20	52,300			
25 If section 1245 property:				
a Depreciation allowed or allowable from line 22			—	
b Enter the smaller of line 24 or 25a				
26 If section 1250 property: If straight line depreciation was used, enter zero on line 26g unless you are a corporation subject to section 291.				
a Additional depreciation after 12/31/75 (see instructions)	5,991			
b Applicable percentage multiplied by the smaller of line 24 or line 26a (see instructions)	5,991			
c Subtract line 26a from line 24. If line 24 is not more than line 26a, skip lines 26d and 26e	46,309			
d Additional depreciation after 12/31/69 and before 1/1/76				
e Applicable percentage multiplied by the smaller of line 26c or 26d (see instructions)				
f Section 291 amount (corporations only)				
g Add lines 26b, 26e, and 26f	5,991			
27 If section 1252 property: Skip this section if you did not dispose of farmland or if you are a partnership.				
a Soil, water, and land clearing expenses				
b Line 27a multiplied by applicable percentage (see instructions)				
c Enter the smaller of line 24 or 27b				
28 If section 1254 property:				
a Intangible drilling and development costs, expenditures for development of mines and other natural deposits, and mining exploration costs (see instructions)				
b Enter the smaller of line 24 or 28a				
29 If section 1255 property:				
a Applicable percentage of payments excluded from income under section 126 (see instructions)				
b Enter the smaller of line 24 or 29a				

Summary of Part III Gains (Complete property columns A through D, through line 29b before going to line 30.)

30 Total gains for all properties. Add columns A through D, line 24	52,300
31 Add columns A through D, lines 25b, 26g, 27c, 28b, and 29b. Enter here and on line 13. (See the instructions for Part IV if this is an installment sale.)	5,991
32 Subtract line 31 from line 30. Enter the portion from casualty and theft on Form 4684, Section B, line 15. Enter the portion from other than casualty and theft on Form 4797, line 5	46,309

Part IV Election Not to Use the Installment Method (Complete this part only if you elect out of the installment method and report a note or other obligation at less than full face value.)

33 Check here if you elect out of the installment method	▶ ☐
34 Enter the face amount of the note or other obligation	▶ $
35 Enter the percentage of valuation of the note or other obligation	▶ %

Part V Recapture Amounts Under Sections 179 and 280F When Business Use Drops to 50% or Less (See Instructions for Part V.)

	(a) Section 179	(b) Section 280F
36 Section 179 expense deduction or section 280F recovery deductions		
37 Depreciation or recovery deductions (see instructions)		
38 Recapture amount. Subtract line 37 from line 36. (See instructions for where to report.)		

Chapter 2 Page 23

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